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GENERAL DISCUSSION ON TRANSNATIONAL CORPORATIONS IN THE WORLD ECONOMY AND TRENDS IN FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

Trends in foreign direct investment

Report of the Secretary-General

SUMMARY

Despite a major decline in the world-wide flows of foreign direct investment in 1991 and in inflows to the developed countries, the growth of inflows to all regions of the developing world increased in absolute and relative terms. This significant feature of foreign-direct-investment flows in 1991 can be attributed to the continued economic uncertainty in the developed countries, the maintenance or resurgence of economic growth and sustained profitability in developing countries, together with the continuing trend towards liberalization. The general trend towards liberalization has also been evident in Central and Eastern Europe whose level of inflows continued to grow. In particular, new policy initiatives such as privatization have increasingly propelled the growth of foreign direct investment in a number of countries in Latin America and Central and Eastern Europe, by expanding the range of new profitable investment opportunities for transnational corporations.

The stagnant global and domestic business environment in 1991 is shown in the declining profitability of investments and the lower share of reinvested earnings as a component of foreign direct investment, particularly in the developed countries. The changing macroeconomic conditions and transnational corporate strategies have also made cross-border mergers and acquisitions less important in the growth of foreign direct investment in the early 1990s.

* E/C.10/1993/1.

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INTRODUCTION

1. At its eighteenth session, the Commission on Transnational Corporations requested the Transnational Corporations and Management Division to prepare a report on trends in foreign direct investment. The present report is in response to that request. It analyses trends in foreign direct investment at the global and regional levels, and examines the changing nature of foreign direct investment during the 1990s.

I. GLOBAL TRENDS

2. A significant feature of foreign-direct-investment flows in 1991 was that the growth of such investment into developing countries continued, leading to an increase in both absolute and relative terms. All developing regions of the world benefited from the increase. The resurgence of growth in several Latin American countries, continued high growth rates in major host countries of Asia and the attractiveness of some countries in Africa for foreign direct investment in natural resources are among the factors that explain this performance. This happened against the backdrop of a decline in world wide investment flows and especially inflows into developed countries (table 1), partly due to recessionary conditions in a number of those countries. (Note that the growth rates in all tables in this report represent compounded growth rate estimates based on a semi-logarithmic equation.) Similarly, foreign direct investment in Central and Eastern Europe continued to increase, largely in response to long-term corporate strategies adopted by transnational corporations in the light of expectations of future growth in that region. The continuing trend towards liberalization in these countries, including the adoption of new policy instruments such as privatization - which have expanded profitable investment opportunities for transnational corporations - is also an explanatory factor. The decline in world-wide investment flows in 1991 represents the first downturn since 1982 and occurred largely because of the recessionary conditions that resulted in a major decrease in outflows from Japan and, to a lesser extent, from Western Europe. The slowdown of economic growth and the declining profitability of investments is reflected in the lower share of reinvested earnings in total investment flows. However, as explained later, despite the decline in flows, foreign direct investment continues to gain in importance as a form of international economic transactions.

3. Investment inflows to developing countries in 1991 increased by more than 20 per cent from 1990, in contrast to the developed countries, whose inflows declined. Developing countries received 25 per cent of all inflows in 1991, which is much higher than their share in the period 1986-1991 and equal to their share in the first half of the 1980s. Strong growth of inflows to East, South and South-east Asia persisted, and there has been a substantial increase to Latin America and the Caribbean as well. Sustained profitability of investments in South and South-east Asia is expected to result in further flows of investment in these countries in the 1990s, particularly from Japan, with the further development of an integrated East Asian production structure. 1/ The resurgence of economic growth and the continuing trend towards liberalization in foreign-direct-investment policies, in combination with

Table 1. Inflows and outflows of foreign direct investment, 1987-1991

Country	1987	1988	1989	1990	1991 a/	1981-1985	1986-1990	1991 a/	1981-1985	1986-1990	1991 a/
	(Billions of dollars)					Share in total (Percentage)			Growth rate (Percentage)		
Developed countries											
Inflows	108	129	165	172	108	74	83	74	0.2	24	-37
Outflows	132	162	203	226	174	98	97	97	3	24	-23
Developing countries											
Inflows	25	30	28	30	36	26	17	25	-4	14	21
Outflows	2	6	10	8	5	2	3	3	33	45	-35
All countries											
Inflows	133	159	193	202	147	100	100	100	-0.9	22	-27
Outflows	135	168	213	234	180	100	100	100	4	24	-23

Sources: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on United Nations Centre on Transnational Corporations, World Investment Directory 1992, vol. I. Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11); Transnational Corporations and Management Division, World Investment Directory 1992, vol. II. Central and Eastern Europe (United Nations publication, Sales No. E.93.II.A.1); vol. III. Developed Countries; vol. IV. Latin America and the Caribbean; vol. V. Africa and Western Asia; vol. VI. Global (United Nations publication, forthcoming); International Monetary Fund, balance-of-payments tape, retrieved on 16 October 1992, and Organisation for Economic Cooperation and Development (OECD) estimates.

a/ Based on preliminary estimates.

/...

privatization initiatives in a number of countries in the Latin America and the Caribbean region, have made these countries increasingly attractive to transnational corporations. Africa has also experienced increasing level of inflows of foreign direct investment in 199/1, largely driven by the presence of rich natural resources in the region. However, despite the growth of foreign direct investment in all developing country regions in 1991, the concentration of investments flows to developing countries has not changed: the 10 largest host countries continue to receive approximately two thirds of all inflows. Flows of investment to the least developed countries grew by 12 per cent in 1991, to $183 million - less than a quarter of inflows to Hong Kong.

4. The growth of foreign direct investment in Central and Eastern Europe has been sustained during 1991 and the first half of 1992, largely in response to long-term corporate strategies adopted by transnational corporations in the light of expectations of future growth in the region. Such growth of foreign investments has also been facilitated by the enactment of liberal foreign-direct-investment regimes in these countries in expectation of the contributions that transnational corporations can make in the transformation of centrally planned economies to market economies. While the pace of growth appears to be slowing down owing to the steep decline in growth in the region as well as recessionary conditions in the home countries of the major investors, foreign direct investment in that region has increased as a proportion of world-wide foreign direct investment. The flows of investment are, however, unevenly distributed among the countries of that region, as is the case with the developing countries.

5. The decline in the world-wide outflows of foreign direct investment in 1991 to $180 billion, from a level of over $230 billion in 1990, represents the first downturn since 1982. The decline in the level of outflows in 1991 is accounted for mainly by the decline of outflows from Japan (which accounts for more than 30 per cent of the world-wide decline and 50 per cent of the decline from the five major home countries) and Western Europe (which accounts for about 61 per cent of the world-wide decline, largely because of the performance of France, Germany, Netherlands and Sweden), the plateauing of outflows from the United States and the deceleration in the rate of growth of outflows from the United Kingdom since 1990. This may be largely attributed to the difficult economic conditions in these countries which prompted transnational corporations to maintain a cautious stance. Outflows from the five major home countries declined by more than 20 per cent to $124 billion in 1991 from their level in 1990, although they sustained their share of about 68 per cent of world-wide outflows during the 1980s. Preliminary estimates for 1992 show that the rate of decline in outflows from these five major countries has been significantly reduced: their outflows in that year are estimated to be in the region of around $112 million (table 2). The stagnant domestic and global business environment and the declining profitability of investments is reflected in the lower share of reinvested earnings as a component of foreign direct investment, particularly in the developed countries.

Table 2. Outflows of foreign direct investment from the five major home countries, 1987-1991

Country	1987	1988	1989	1990	1991	1992 a/	1981-1985	1986-1990	1991	1981-1985	1986-1990	1991
	(Billions of dollars)						Share in world total (Percentage)			Growth rate (Percentage)		
France	9	14	19	35	24	14 b/	6	10	13	-17	45	-31
Germany	9	13	18	28	21	16 c/	9	9	12	13	27	-24
Japan d/	20	34	44	48	31	16 e/	11	19	17	8	32	-36
United Kingdom	31	37	36	18	19	16 c/	19	17	11	-2	2	7
United States f/	26	14	26	29	29	50 c/	23	13	16	-5	16	-0.4
Total g/	95	112	143	158	124	112	68	68	69	.01	23	-21

Sources: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division World Investment Directory 1992, vol. III. Developed Countries (United Nations publication, forthcoming); IMF, balance-of-payments tape, retrieved on 16 October 1992.

a/ Based on preliminary estimates.

b/ Estimated, based on outflows in the first two quarters of 1992.

c/ Estimated, based on outflows in the first three quarters of 1992.

d/ Not including reinvested earnings.

e/ Estimated, based on outflows in the first quarter of 1992.

f/ Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles. Also excludes currency-translation adjustments.

g/ Totals may not add up, due to rounding.

6. As with 1990, outflows from developing countries declined in 1991 from a period of substantial growth in the late 1980s, particularly by the Asian newly industrializing economies. However, despite their decline in 1991, the share of developing countries in world investment outflows in 1986-1990, at over 3 per cent, is much higher than their 0.7 per cent share in 1970-1975. The estimated stock of foreign direct investment from developing countries was $110 billion by the late 1980s. 2/ Although foreign direct investment from developing countries still remains small on a global scale, these investments are exhibiting rapid growth in terms of both value and number of home countries. The geographical destination of these investments has also widened, to include developed countries where they accounted for some 5 per cent of total inward investment stock in the late 1980s, compared to about 20 per cent in developing countries. This outward foreign direct investment by developing countries is likely to have exerted positive effects on the access to technology, skills and markets for their home economies. 3/

7. Despite the decline in world-wide flows of foreign direct investment in 1991, the world-wide stock of foreign direct investment continued to increase, to reach some $1.9 trillion in book value. The world-wide stock of foreign direct investment is a better measure of the importance of the activities of transnational corporations in the world economy since it represents the capacity to produce output on a continuing basis (see E/C.10/1993/3). The activities of some 35,000 parent transnational corporations and their close to 160,000 foreign affiliates generated approximately $5.5 trillion in world-wide sales in 1990, compared to world exports of goods and services of $3.3 trillion ($2.2 trillion, excluding intra-firm trade). Indeed, the rate of growth of world-wide outflows of foreign direct investment during the period 1986-1990 was three times that of world-wide gross domestic product, almost two and one half times that of world-wide exports and domestic investment and considerably faster than receipts of technology. 4/ By 1991, although the level of world-wide outflows declined, the rate of growth of the world-wide stock still grew faster than the other economic indicators (table 3). Thus, the relative importance of foreign direct investment in the world economy continues to increase.

8. Apart from the increasing relative importance of foreign direct investment in the world economy, the composition of this investment appears to be changing. Overall, the share of foreign direct investment financed through new equity capital and short- and long-term capital increased considerably between the periods 1981-1985 and 1986-1991, at the expense of reinvested earnings whose share declined significantly; but there are considerable variations among different home countries (table 4). The declining importance of reinvested earnings may be due to falling profits during the 1980s in member countries of the Organisation for Economic Cooperation and Development (OECD). It is also significant that the share of reinvested earnings in inward foreign-direct-investment flows of the developed countries became negative in 1990-1991, a period marked by even lower rates of return than during the 1980s. 5/ Generally, the more traditional home countries of foreign direct investment - such as the United Kingdom and the United States - have a higher proportion of reinvested earnings in their investment outflows than the newer home countries. In terms of inflows, reinvested earnings are a considerably more significant component of foreign direct investment in developing countries

Table 3. World-wide foreign direct investment and selected economic indicators, 1991, and growth rates for 1981-1985, 1986-1990 and 1991

Indicator	Value, 1991, (current prices in billions of dollars)	Annual growth rate, 1981-1985 (percentage)	Annual growth rate, 1986-1990 (percentage)	Annual growth rate, 1991 (percentage)
Foreign-direct-investment outflows	180	4	24	-23
Foreign-direct-investment stock	1 900	5	11	11
Sales of transnational corporations	5 500 a/	2 b/	15	..
Current gross domestic product at factor cost	22 300 b/	2	9	-6 c/
Gross domestic investment	5 100 b/	1	10	..
Exports	3 500	2	10	4
Royalties and fees receipts	30 c/	-1	20	-1

Sources: The Department of Economic and Social Development, Transnational Corporations and Management Division, based on IMF, balance-of-payments tape, retrieved on 16 October 1992; World Bank, World Development Report, 1992 (Washington, D.C.); IMF, Direction of Trade Statistics, Yearbook, 1992 and 1988 (Washington, D.C.); Transnational Corporations and Management Division, World Investment Directory, vol. VI. Global Volume (United Nations publication, forthcoming).

a/ For 1990.

b/ For 1982-1985.

c/ Estimate.

Table 4. Share of reinvested earnings in outward foreign-direct-investment flows, 1981-1985, 1986-1990 and 1991 (percentage)

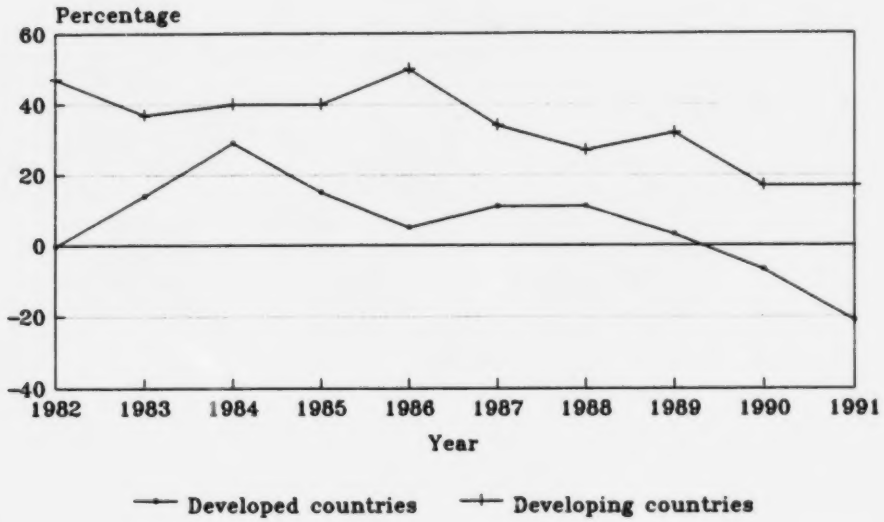
Home country	1981-1985	1986-1990	1991
Australia	23	32	46
Finland	-19	5	..
Germany	5	13	17
Israel	10	33	11
Netherlands	29	21	..
New Zealand	96	43	77
Sweden	25	19	18
Switzerland	61 a/	35	..
United Kingdom	50	45	66
United States	116	71	61
Total, above	60	39	39

Sources: The Department of Economic and Social Development, Transnational Corporations and Management Division, based on United Nations Commission on Transnational Corporations, World Investment Directory 1992, vol. I. Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11); vols. III-VI (United Nations publication, forthcoming); IMF, balance-of-payments tape, retrieved on 16 October 1992.

a/ For 1983-1984.

than in developed countries (fig. I). This indicates that a larger proportion of foreign direct investment in developing countries is financed from earnings generated within the host country. By contrast, in developed countries, finance for inward foreign direct investment is sourced overwhelmingly from funds mobilized abroad; hence the nature of foreign-direct-investment activity in developed countries has more of a cross-border nature, compared to that in developing countries where foreign direct investment is sustained through profits earned from within. 6/ It is not clear whether the higher proportion of reinvested earnings in total inward foreign direct investment in developing countries is due to higher rates of return or lower rates of profit repatriation. If the profit rates of United States foreign affiliates in developed and developing countries is any indication, significantly higher profit ratios are earned in developing countries at 9 per cent compared to developed countries at 5 per cent. 7/ At any rate, the high share of reinvested earnings suggests that a substantial part of inflows is not financed by foreign savings. On the other hand, in so far as earnings represent a pool of potentially repatriable resources, a higher rate of reinvestment implies the productive use of those resources within host economies.

Figure I. Share of reinvested earnings in inward foreign-direct-investment flows, 1982-1991



Source: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division, World Investment Directory, vol. VI. Global Volume (United Nations publication, forthcoming).

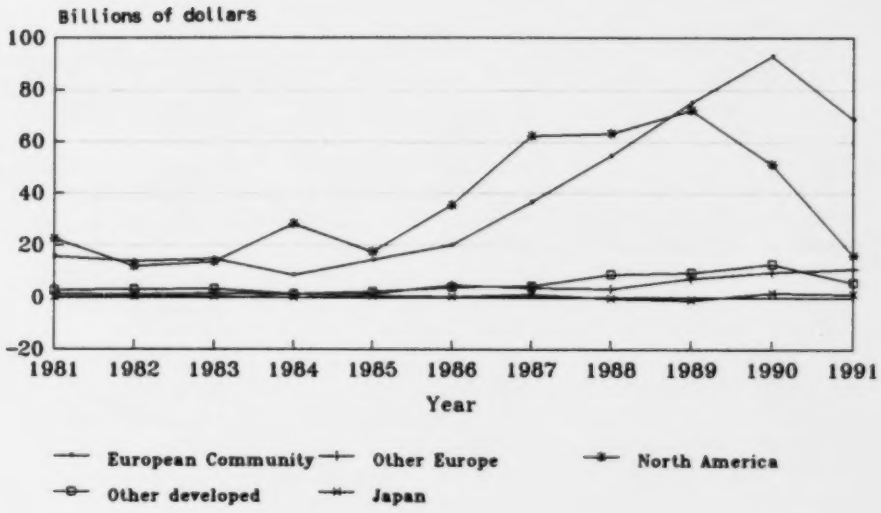
II. REGIONAL TRENDS

A. Developed countries

9. The level of investment outflows from the developed countries declined in 1991, largely due to a significant slow-down of growth, continuing concerns about economic uncertainty in major industrialized countries and structural weaknesses in the financial systems in a number of countries that rendered finance capital more difficult to obtain or available only at increased costs (see fig. II). 8/ These factors made transnational corporations maintain a cautious stance and prompted them to concentrate on improving the efficiency of existing investments, rather than adding to capacity or undertaking new investments. Evidence for this is provided in the much slower pace of growth of mergers and acquisitions as a mode of foreign-direct-investment activity in the early 1990s. The decline in outflows was accounted for largely by Japan (whose outward foreign direct investment declined for the first time since 1983) and Western Europe. The drop in foreign direct investment from Japan alone amounted to $17 billion, accounting for 50 per cent of the decline in foreign-direct-investment outflows from the five major countries. In spite of that, developed countries continue to account for over 97 per cent of world-wide outflows of foreign direct investment. The level of investment inflows to the developed countries similarly declined in 1991 and was due mainly to the United States (whose inflows declined by 75 per cent in 1991 and which accounted for over 52 per cent of the decline in inflows to developed countries), and to a lesser extent the European Community (table 5). Despite the reduced inflows to the European Community in 1991, the share of intra-European Community investment continued to increase. By contrast, the member countries of the European Free Trade Area have experienced a sustained growth of inflows, although at a slackened pace. Meanwhile, inflows in Japan continue to remain at low levels.

10. One explanation for the decline in investment outflows in 1991, as noted above, is the significant reduction in the role of cross-border mergers and acquisitions in the early 1990s. 9/ Even French companies, which have engaged in large-scale overseas acquisitions since 1987, have slowed down these activities sharply since 1990. 10/ The merger wave of the 1980s was in part a result of macroeconomic conditions that affected most developed economies and included the deep recession at the beginning of the decade which, combined with more intense international competition, created substantial excess capacity in many low- and medium-technology industries, such as petroleum and consumer durables. In addition, fairly substantial growth in the availability of credit later in the decade and the valuation of many companies below their asset or break-up values contributed to the merger boom. Many transnational corporations sought to narrow their business base to emphasize core activities, while others saw existing conditions as conducive to expanding into new markets or activities. The goal of a single market within the European Community stimulated many transnational corporations to engage in mergers and acquisitions as a quick means to gain a foothold or to rationalize their European operations in preparation for the single market. 11/ The slowing down of the merger wave coincided with the end of the conditions that had created it. The speculative environment that had been established by the late 1980s

Figure II. Outflows of foreign direct investment from developed regions and country, 1981-1991



Source: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division, World Investment Directory 1993, vol. III. Developed countries (United Nations publication, forthcoming).

Table 5. Inflows of foreign direct investment to the developed countries, by region, 1987-1991, and shares, 1981-1985, 1986-1990 and 1991

Region	1987	1988	1989	1990	1991	1981-1985	1986-1990	1991 a/
	(Billions of dollars)					Share in total (Percentage)		
Western Europe	40	57	86	109	85	42	50	78
of which:								
European Community	36	54	79	99	74	38	45	69
Other Western Europe	4	3	7	10	10	4	5	10
North America	62	63	71	52	16	50	44	15
Other developed regions	6	8	8	11	8	8	6	7
of which: Japan	1	-0.5	-1.1	1.8	1.4	3	0.2	1
Total, above a/	108	129	165	172	108	100	100	100

Source: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division, World Investment Director 1993, vol. III. Developed Countries (United Nations publication, forthcoming); IMF, balance-of-payments tape, retrieved on 16 October 1992, and Organisation for Economic Cooperation and Development estimates.

a/ Totals may not add up, due to rounding.

had led to a number of instances in which acquiring companies overpaid for corporate assets, and slower economic growth contributed to a number of well-publicized corporate failures, such as the Campeau Corporation (Canada). Tighter monetary policies, higher interest rates and higher stock-market valuations made acquisitions more costly. Moreover, the wave of regional restructuring was followed by a period whereby transnational corporations consolidated their positions and concentrated on developing effective structures to manage their newly reorganized networks. Thus, with the changing macroeconomic conditions and corporate strategies, the early 1990s have seen a much slower pace of mergers and acquisitions.

11. There has also been a sharp decline in foreign direct investment from Japan, whose outward investment declined in 1991 for the first time since 1983, as the country's economic slow-down, declining profitability and the collapse of financial markets left Japanese companies with less capital to invest abroad and obliged some to sell foreign assets to cover losses at home. In addition, the drive of Japanese transnational corporations to set up manufacturing bases in North America and the European Community in automobiles, steel and electronics in the late 1980s abated - at least for the time being. 12/

12. Outward investment from most Western European countries also declined in 1991, owing largely to less favourable economic growth prospects which, together with previously accumulated large-scale investment outlays, reduced the incentive of firms to further expand their investments abroad. 13/ Only Belgium, Denmark, Luxembourg, Norway, Portugal and the United Kingdom

experienced a growth of outflows in 1991. In addition, the level of Swiss direct investment abroad is expected to grow with the recognition of the importance of being more international and declining locational advantages of the home market. A number of Swiss firms are actively building up operations abroad; at the end of 1990, the 15 biggest Swiss enterprises employed 684,700 people, or 82 per cent of their total work force, outside Switzerland. 14/

13. A major contributory factor to the lower level of inflows to the developed countries in 1991 is the decline in inflows into the United States by almost 75 per cent in 1991 from the previous year, to $11.5 billion, the lowest since 1983, which is in sharp contrast to the record high of $67.9 billion in 1988. The decline in United States inflows is associated with very slow economic growth in that country, decline in profitability, high start-up costs and large interest payments on debt incurred to finance earlier acquisitions as well as liquidity or excess-capacity problems in the banking, finance and real estate industries where foreign direct investment has been large. 15/ These are among the factors that explain why Japan, the most dynamic source of new inflows into the United States, has not increased its investments in the United States. 16/

14. The inflows to Western Europe also declined to their 1989 level, because of reduced foreign direct investment in the European Community (particularly in Germany, Italy, Netherlands, Spain and the United Kingdom), and the slow down of growth of investments into countries of the European Free Trade Area. The reduced inflows in the European Community may be due to dampened business confidence in the region owing to the recessionary conditions in several countries, aggravated by some uncertainties over the future of the Maastricht Treaty, and the implications that this may have on long-term investment planning by transnational corporations. The fall in new inflows to the Community is also a reflection of the fact that most foreign companies and, in particular, those from Japan, have already established a foothold within the Community, and have shifted their emphasis towards a more rigorous assessment of the role of their existing investments in their long-term strategies. Hence, the early 1990s has seen restructuring efforts undertaken by Japanese companies of their European operations in order to create greater efficiencies and to achieve a better coordinated regional network in Europe, in part through hastening the pace of the localization of their operations and increasing their research-and-development projects within the Community. 17/ However, despite the uncertainties that partly explain reduced inflows in the Community, the general trend towards liberalization of foreign-direct- investment policies in the European Community countries, such as in France, has resulted in many ground-breaking alliances with foreign firms in previously protected State industries. 18/ Privatization as an instrument of economic liberalization has also undoubtedly attracted foreign participation in a number of other European countries. 19/ However, countries have differed in the extent to which foreign investment has actually been encouraged in privatized industries. 20/

15. The sustained growth of foreign direct investment in the European Free Trade Area, although at a slackened pace, may be explained by the trend towards liberalization and deregulation of international capital movements pursuant to the establishment of the European Economic Area which will come into effect at the same time as the Single European Market programme on 1 January 1993, as

well as the anticipation of early inclusion of some of these countries (Austria, Finland, Norway and Sweden) in the European Community. In particular, foreign direct investment in Sweden grew more than three times in 1991 as a result of significant acquisitions by foreign companies and the growth of joint ventures and strategic alliances between domestic and foreign companies. 21/ The increase in foreign business interests in Sweden also reflects a positive response by transnational corporations to the country's efforts to achieve a more competitive and deregulated economy, associated with its commitment to join the European Community by 1995 and to be a party to its economic and monetary union. The adoption of a free market industrial strategy in 1992, including privatization and the lifting of legal restrictions that hamper new foreign investments, is likely to increase foreign direct investment in Sweden in the future. 22/ The trend towards liberalization of foreign investment is also evident in Switzerland where increasing amounts of foreign capital are required to bolster the declining Swiss capital market. It remains to be seen to what extent the rejection of the European Economic Area agreement in December 1992 will affect negatively the attractiveness of Switzerland as an investment location, especially in industries not covered by separate integration agreements (as in the case of insurance).

16. Efforts towards convergence of policies in the European Community and the European Free Trade Area countries to achieve an economic and monetary union in 1997 or 1999 are likely to have a positive influence on foreign direct investment in Europe in the future, through the relaxation of most controls that inhibit its growth, such as the dismantling of monopolies, the liberalization of protected industries and other forms of foreign capital control. 23/

17. The low level of foreign direct investment in Japan has continued in the early 1990s for several reasons. At the macro level, the factors inhibiting inward investment include government preference of licensing over foreign direct investment, an ineffective liberalization process, difficulties in acquisitions and keiretsu relationships. There are also various problems facing individual companies in doing business in Japan, some of which are uniquely rooted in Japanese business practices and some of which are common problems in doing business in a foreign environment (see the box).

Box. Why is foreign direct investment in Japan so low?

In 1990, Japan became the fourteenth largest host country in terms of inward foreign-direct-investment stock - a significant growth from the country's position in 1980 as the twenty-first largest. However, despite the increased importance of Japan as a recipient of foreign direct investment, the country's share in world-wide stock has remained at very low levels. Moreover, the level of inward stock in Japan was still one fifteenth of that of Japanese outward investment stock as of March 1992.

Historically, the Government of Japan has placed emphasis on preserving and improving indigenous technological and managerial capabilities by importing foreign technology through arms-length transactions, primarily in the form of licensing. Even by the 1987-1991 period, the value of technological imports (defined as payments of royalties and license fees to foreign owners of patents, copyrights and other non-financial intangible assets) of Japan was nearly ten times as high as inflows of foreign direct investment. a/ The value of its technological imports was, in most cases, two or three times that of other major developed countries such as France, Germany, the United Kingdom and the United States. A preference for licensing as a mode for the acquisition of technology reduces the demand for foreign direct investment.

The liberalization of inward foreign-direct-investment policies starting in 1967 has not led to any significant growth of such investment in Japan because of the slow implementation process. For example, only industries that have achieved international competitiveness have been gradually liberalized to foreign competition. Although full liberalization was achieved in principle in 1976, foreign direct investment remains closed in four industries - agriculture, forestry and the fishery industry (counted as one), mining, oil exploration and leather and leather products. Until 1990, the Foreign Exchange and Foreign Trade Control Law enabled the Government to restrict inward foreign direct investment on the grounds that the investment might adversely affect similar domestic business activities or the smooth performance of the Japanese economy. The restrictions also played a part in regarding inflows of foreign direct investment.

Difficulties faced by foreign firms in merger-and-acquisition activities in Japan also constitute another reason for the low level of inward foreign direct investment. a/ Hostile take-overs (take-over bid system) were institutionally difficult until 1990, because prior notification was required. Thus, targeted companies could prepare in time to defend themselves from an impending take-over. Apart from this factor, the practice of shareholdings owned by financial companies and keiretsu firms, lifetime employment and the seniority system may have made mergers and acquisitions difficult for foreign firms.

Certain aspects of keiretsu relationships promote preferential group trade and negatively affect foreign direct investment in Japan. c/ Anti-competitive and exclusive business practices decrease the transparency of business transactions and place non-keiretsu firms and, in particular, foreign firms in a disadvantageous position. Other problems inhibiting inward foreign direct investment at a company level include, among others, high costs of doing business and staffing problems, as well as the complex, multilayered distribution system. d/ These problems are more profound in Japan than in other countries since they are related to the uniqueness of Japanese business practices.

Despite the difficulties, there are signs that inflows of foreign direct investment into Japan are increasing. Inflows in the first half of 1992 were almost twice as high as in the corresponding period in 1991. e/ It also seems that increasing merger-and-acquisition activity by foreign firms is behind the increase in inflows, prompted by declining profitability of Japanese firms. f/ Not only can foreign firms now resort to take-overs more easily, they can also purchase Japanese firms at less than one half of the cost of acquisition in 1990. The decline in Japanese real estate and stock prices over the past two years and the restructuring of Japanese industries have provided foreign firms with their best opportunity in many years to set up, expand or acquire business in Japan. Moreover, with the recent government commitment to promote investment inflows, the potential of Japan becoming a more significant host country for foreign direct investment has become stronger. g/

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a/ Data on payments of royalties and license fees are from the International Monetary Fund balance-of-payments tape retrieved in November 1992. Payments include payment to both affiliated and non-affiliated foreigners by domestic firms and transnational corporations.

b/ See Robert Z. Lawrence, "Why is foreign direct investment in Japan so low?", Transnational Corporations (1 January 1993).

c/ Ibid.

d/ Quoted in "Trade and investment in Japan: the current environment", Center for Industrial and Technological Cooperation News (Tokyo, Japan External Trade Organisation, September 1992), p. 1; Ministry of International Trade and Industry, Gaishi-kei Kigyo no Doko. The 25th Survey (Tokyo, Ministry of Finance Printing Bureau, April 1992), table 60, pp. 166-167.

e/ Nihon Keizai Shimbun (19 August 1992), p. 5. Data on inward foreign direct investment here are based on notification basis (ex post facto report since April 1991) reported by the Ministry of Finance. Since the data exclude withdrawals and cancellations of foreign direct investment after reporting, they are normally larger than the data on inflows reported in the balance of payments.

f/ In the first half of 1992, the number of members and acquisitions of Japanese companies with overseas corporations more than doubled to 16 transactions, compared to the previous year. The number of acquisition by United States companies rose to 10 from 3 in the same period last year, while those from Europe halved to two deals. The value of the transactions, however, fell 43 per cent to $105 million in the first half of 1992. See also Emiko Terazono, "Foreigners find Japanese companies attractive", Financial Times (2 July 1992).

g/ "Japan's trade surpluses: the long-term solution", The Economist (13 June 1992); and "Japan mulls tax incentives for foreign-based firms", The Wall Street Journal (9 September 1991).

18. Despite the decline in inflows of foreign direct investment into the developed market economies, these countries accounted for almost three quarters of world-wide inflows in 1991. The "triad", consisting of the European Community, Japan and the United States, accounted for approximately three fifths of world-wide inflows, a proportion much below its share of 70 per cent during the decade of the 1980s, and 86 per cent of outflows, compared to its share of 81 per cent during the 1980s. The triad has therefore become much more important as a home region of foreign direct investment in 1991, while its significance as a host region has diminished. The expanded triad - consisting of Western Europe, North America and Japan - on the other hand, accounted for 70 per cent and 96 per cent of global inflows and outflows in 1991, respectively.

B. Developing countries

19. Except for 1989, developing countries have experienced a consistent increase in the absolute level of inward investment since 1984. By 1991, while inflows to the developed countries declined, the level of inflows to the developing countries reached a total of $36 billion, representing over 20 per cent growth over the level in 1990. The share of developing countries in world-wide inflows in 1991 reached one quarter, which is much higher than their share in the period 1986-1991 and equal to their share in the first half of the 1980s. Such growth of inflows has been experienced by all developing regions and is associated with continued strong economic growth in Asia and the Pacific and the resurgence of growth in a number of Latin American countries (Brazil, Ecuador, Mexico and Paraguay), combined with the continuing trend towards liberalization in a wide spectrum of developing countries. Although East, South and South-East Asia continues to account for over half of the inflows to developing countries, the region's share in total flows to developing countries has declined from 1990. On the other hand, the level of inflows experienced by Latin America and the Caribbean has grown significantly in 1991, largely as a result of improvements in macroeconomic performance, combined with new policy initiatives that increased prospects for new profitable investment opportunities in the region. Flows to Africa increased by 45 per cent in 1991, while those to the least developed countries rose marginally and accounted for the meager share of half of 1 per cent of total inflows to developing countries in 1991. In 1992, foreign direct investment into developing countries may well have increased further, to reach some $40 billion. 24/

20. Among developing countries, a large proportion of investment inflows continues to be directed to a small number of countries (table 6) that have locational advantages attractive to transnational corporations. However, there is a discernible trend towards declining geographical concentration of investments in the 10 largest host countries (from over 70 per cent in the period 1981-1985 to 65 per cent in the period 1986-1990). Hence, the increasing inflows of foreign direct investment in developing countries have been also accompanied by lesser geographical concentration.

Table 6. Inflows of foreign direct investment to developing countries, by region, 1981-1985, 1986-1990 and 1991

Country	1981-1985	1986-1990	1991	1981-1985	1986-1990	1991	1981-1985	1986-1990	1991
	Average (Billions of dollars)			Share in total (Percentage)			Growth rate (Percentage)		
All countries	50.00	153.00	147.00	100.00	100.00	100.00	-1.00	22.00	-27.00
Developing countries	13.00	26.00	36.00	26.00	17.00	25.00	-4.00	14.00	21.00
Africa	2.00	3.00	3.00	3.00	2.00	2.00	12.00	6.00	45.00
East, South and South-East Asia	5.00	13.00	19.00	10.00	9.00	13.00	-3.00	21.00	12.00
Latin America and the Caribbean	6.00	9.00	13.00	12.00	6.00	9.00	-10.00	9.00	36.00
Oceania	0.10	0.10	0.20	0.30	0.10	0.10	-2.00	27.00	-26.00
West Asia	0.40	0.50	0.90	1.00	0.30	1.00	7.00	27.00	2.00
Other a/	0.03	0.05	0.05	0.10	0.03	0.03	-10.00	103.00	..
Least developed countries	0.20	0.10	0.20	0.30	0.10	0.10	-0.40	1.00	12.00
Ten largest host developing economies	9.00 b/	17.00 c/	24.00 d/	18.00 b/	11.00 c/	16.00 d/	-4.00 b/	8.00 c/	28.00 d/

Sources: Department of Economic and Social Development, Transnational Corporations and Management Division, based on United Nations Centre on Transnational Corporations, World Investment Director 1992, vol. I, Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11); vol. III, Developed Countries; vol. IV, Latin America and the Caribbean; vol. V, Africa and Western Asia; vol. VI, Global Volume (United Nations publication, forthcoming); IMF, balance-of-payment tape, retrieved on 16 October 1992 and OECD estimates.

a/ Malta and Yugoslavia.

b/ Argentina, Brazil, China, Colombia, Egypt, Hong Kong, Malaysia, Mexico, Nigeria and Singapore.

c/ Argentina, Brazil, China, Egypt, Hong Kong, Mexico, Nigeria, Singapore, Taiwan Province of China and Thailand.

d/ Argentina, Brazil, China, Indonesia, Republic of Korea, Malaysia, Mexico, Taiwan Province of China, Thailand and Venezuela.

21. Despite the decline in 1991, outflows from developing countries grew almost twice as fast as those of the developed countries during the period 1986-1990. Countries from the Asia and Pacific region account for an overwhelming proportion of these outflows. However, the share of developing countries in world-wide investment outflows still remains small.

22. The implementation of the single European market at the end of 1992 may have an important bearing on trade and foreign direct investment in developing countries in the 1990s. The concern of many developing countries is that the implementation of the single market programme may have an adverse effect on their investment inflows as well as trade, owing to internal pressures that may cause the Community to become more protectionist. For example, although full economic integration is primarily concerned with the removal of internal non-tariff barriers, the re-allocation of factors of production induced by market integration may increase the competitiveness of European-based firms and, as a result, impose adjustment costs on less-efficient producers in developing countries, particularly if the Community implements policies designed to promote European sourcing. Hence, the implementation of European sourcing policies and rules of origin might result in trade and investment diversion to the Community away from developing countries. Similarly, the harmonization of technical, health and safety standards may raise the export requirements of member States to the detriment of developing countries. More generally, the expectation for favourable growth associated with full integration could increase the attractiveness of the Community as a location for foreign direct investment from all countries, to the detriment of developing countries. 25/

23. However, larger-scale diversion of trade and investment from developing countries on account of the single market programme appears unlikely, in part since such investments are industry- and host-country specific, prompted largely by the need to gain access to rich natural resources, the need to supply large and rapidly growing domestic markets or to take advantage of lower production costs for exports. Although the changing structure of production associated with full economic integration and growth is expected to alter the basis of interdependence between the Community and developing countries, this is unlikely to affect in a substantial way resource-based production in developing countries, given the low elasticities of demand for primary products. Similarly, full European integration is not likely to affect the underlying rationale for import-substituting investments in developing countries in the long-run, even though there may be some diversion of foreign direct investment in the short-run. Export-oriented foreign direct investment in developing countries is also not likely to be affected, given the minimal amount of these investments that is made to serve the European Community. 26/ In any case, the objectives of the completion of the single market are geared more towards improving the competitiveness of the European Community in world markets, rather than with protectionism from outside competition. Indeed, the trend of inflows of foreign direct investment into developing countries in the period since the mid-1980s, when the European Community announced its programme to complete the formation of the single market in 1992, shows no negative impact. 27/ This finding confirms another recent study which concluded that, given other determinants of such investments, the potential effects of 1992 on foreign direct investment in developing countries are relatively unimportant. 28/ On the contrary, increased economic growth likely to result

from the single market may increase available resources to sustain growth of outward foreign direct investment from the member countries and may increase their demand for goods produced by their transnational corporations in developing countries, leading to an increase in both trade and investments. The changing structure of production associated with full economic integration and growth is expected to result in the greater importance of trade and foreign direct investment in manufactured products in developing countries as opposed to primary products, with the likelihood that increasing amounts of less skill- and capital- and technology-intensive stages of industrial production may be transferred to these countries from the Community. 29/ Even foreign direct investment by services transnational corporations in developing countries is expected to increase with the acceleration of growth rates in the Community. The precise implications for trade and foreign-direct-investment activity in developing countries of the single European market will have to depend on the outcome of certain crucial determinants such as the external trade policies adopted, including rules of origin, and the harmonization of technical, health and safety standards, among others. Of these determinants, trade policies of the Community exert the greatest impact on the functioning of transnational corporate activities in developing countries.

1. Asia and the Pacific

24. Investment inflows to Asia and the Pacific continued to increase in 1991, to reach over $19 billion (an increase of 12 per cent over the previous year), in response to strong economic growth. 30/ The newly industrializing economies and Indonesia, Malaysia and Thailand accounted for about three quarters of these inflows. The favourable domestic conditions in Indonesia, Malaysia and Thailand have attracted transnational corporations to these countries, resulting in their increased share of inflows to all countries in Asia and the Pacific. Lower production costs and the liberalization of the foreign-direct-investment regime in India have also resulted in a notable increase in inflows to that country. However, China emerged as the single largest recipient of investment inflows, attractive because of both the size of its domestic market and low labour costs. There is also an emerging trend in some countries of the region - such as in Malaysia and Thailand - to improve the quality of foreign direct investment, such as to increase domestic linkages and encourage investments in technologically advanced industries. Japan continues to be a significant investor in the region, where the profitability of investments is higher than in the developed countries. Investment outflows from Asia fell sharply in 1991, primarily accounted for by Taiwan Province of China. Nevertheless, the Republic of Korea and Taiwan Province of China continue to be net exporters of foreign direct investment. The increasingly intra-regional nature of these investments, as of the other home countries in the region, has strengthened regional economic interdependence.

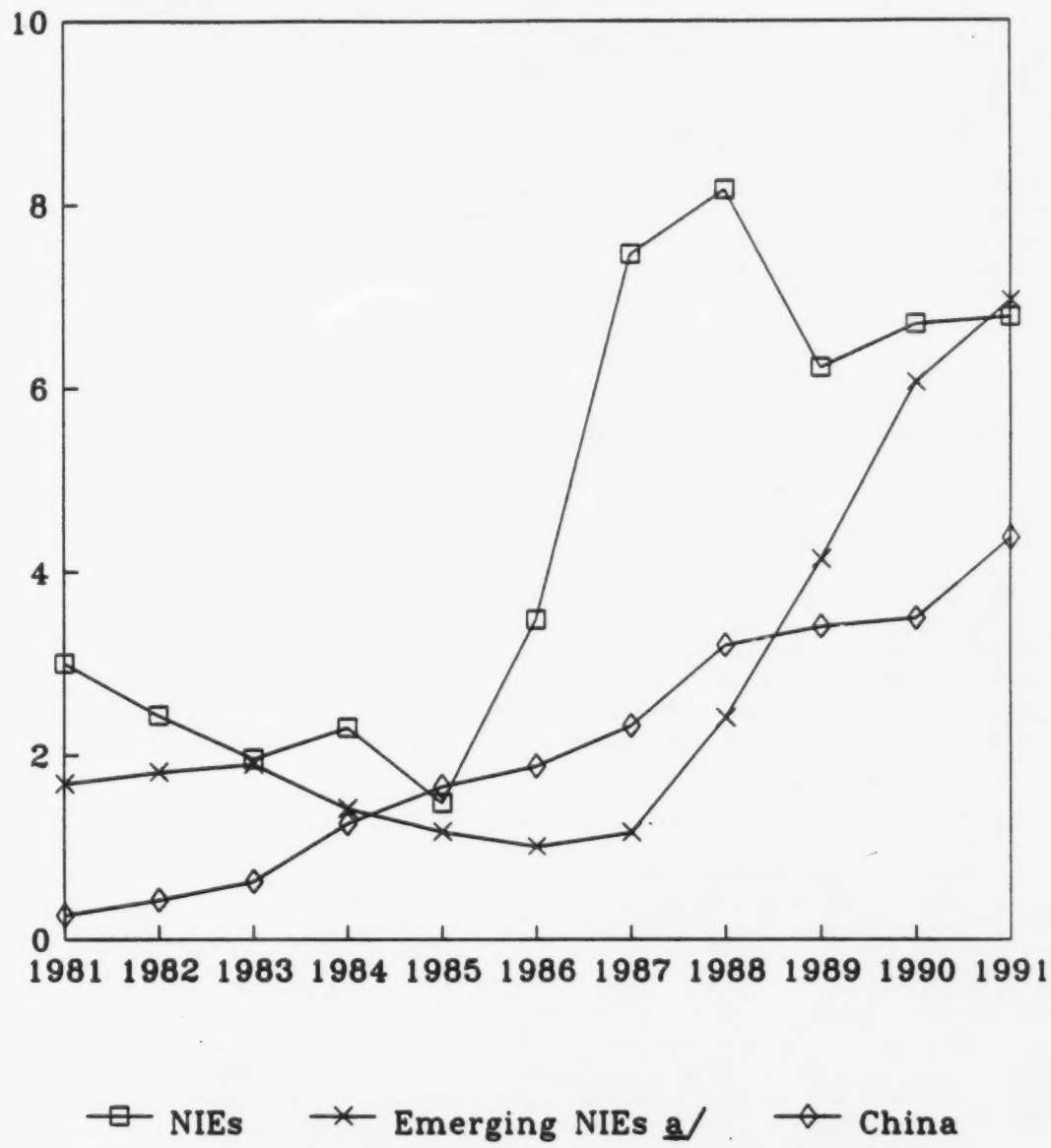
25. Investment inflows in Asia and the Pacific have continued to grow, reflecting strong economic performance and the associated increase in consumer spending and growth of demand, reinforcing the large domestic markets of a number of countries in the region. In addition, the availability of skilled labour and low production costs continue to encourage transnational corporations (especially those from the newly industrializing economies) to use the region as a production base from which to supply home markets and the rest

of the world. Natural-resource industries of the newly opening economies in Asia (in particular Viet Nam and, to a lesser extent, Cambodia) have attracted investments from several transnational corporations from Japan and the newly industrializing economies. 31/ Hence, the geographical distribution of investment inflows in the region has changed significantly in the course of the 1980s (fig. III). The fall in the share of inflows in Asia and the Pacific accounted for by the newly industrializing economies since 1987 is accompanied by a rise in the share received by Indonesia, Malaysia and Thailand. Although the newly industrializing economies continue to be significant recipients of investment flows, rising labour costs in these economies have led some transnational corporations to seek investment locations in China and South Asia where production costs are comparatively lower. For instance, the liberalization of the foreign-direct-investment regime in India has resulted in a significant increase in investments there; the value of foreign equity in joint ventures approved in the first seven months of 1992, at slightly over $1 billion, was almost three times as large as that for the whole of 1991, at $360 million. 32/

26. Another change in the geographical composition of investment flows in Asia and the Pacific is the emergence of China as one of the largest recipients of investment inflows among all countries in the region during 1990-1991. Indeed, in 1991, China became the largest recipient of inflows among all developing countries. There are indications that this trend is likely to continue in 1992 and beyond: investment on a contract basis during the first two quarters of 1992 was about $15 billion, in comparison to $12 billion for the whole of 1991. 33/ The principal reasons for the increase in inflows to China are the same as those for the region as a whole: high rates of growth, coupled with a large domestic market and rising incomes. 34/ With a large supply of labour at low costs, China is also viewed as a low-cost production base for goods to be exported abroad. A more liberal attitude towards foreign direct investment in the services sector, steps towards the normalization of China's relationship with some of its neighbours (Indonesia, Singapore and Taiwan Province of China), coupled with the renewal of the most-favoured-nation status with the United States have also contributed to the growth of foreign direct investment. The present increase in investment inflows also suggests that the impact of the Tiananmen Square incident on the decisions of companies on whether or not to invest in China is wearing off. 35/ For example, Motorola has renewed plans to invest in a manufacturing plant of semiconductors and communications equipment for supplying mostly the domestic market, a project that was suspended in 1989. 36/

Figure III. Foreign-direct-investment flows to Asia, 1981-1991

(Billions of dollars)



Source: Department of Economic and Social Development, Transnational Corporations and Management Division, based on United Nations Centre on Transnational Corporations, World Investment Directory 1992, vol. I. Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11) and Transnational Corporations and Management Division, foreign-direct-investment database.

Note: NIE = newly industrializing economy.

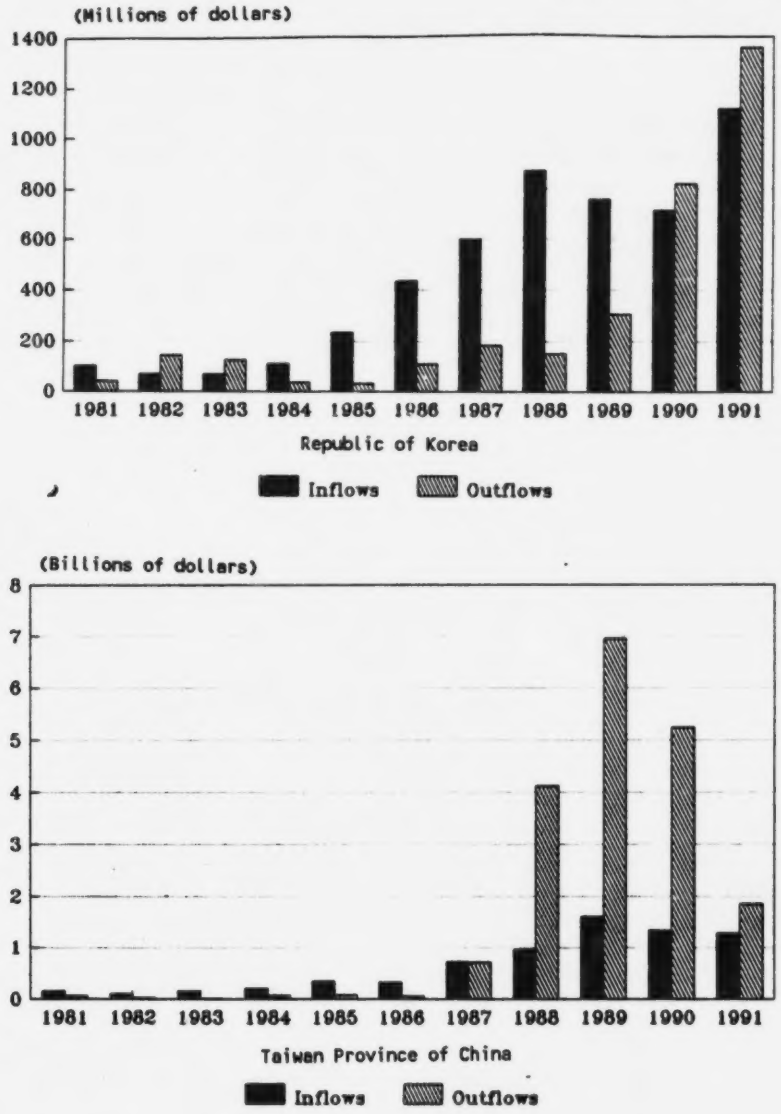
a/ Indonesia, Malaysia, Thailand.

27. The sectoral composition of foreign direct investment in the region is also likely to change rapidly. Malaysia, for example, has shifted its policy focus towards attracting investments in technology-intensive industries, such as semiconductors or petrochemicals, in combination with those that are less import-intensive, and use the host country's natural resources. The shift of policy towards encouraging investments in technology-intensive industries is geared towards increasing the competitiveness of technologically sophisticated industries. More specifically, in the case of Malaysia, the objectives of the policy shift are to broaden and deepen the industrial base; to promote capital-intensive and technologically sophisticated industries in view of the low rate of unemployment; to develop intermediate and capital-goods industries; and to promote linkages between foreign and domestic companies. To meet these objectives, revisions in the tax-incentive system aimed at encouraging investments in higher value-added industries and at enhancing export capabilities of foreign firms have been introduced. Investments in the services sector are also encouraged. There have also been proposals to offer incentives to affiliates to increase linkages with domestic producers via local procurement, staff training and transfer of technology. 37/ Some industrial upgrading towards more technologically intensive investments are already being undertaken by foreign oil and gas and some computer firms in Thailand.

28. Japan continues to be a major source of foreign direct investment for Asia and the Pacific despite a fall in the level of that country's outward investment to the region in 1991. The profitability of its investments in Asia is likely to encourage future Japanese investments in the region. 38/ Faced with the rising cost of capital at home, Japanese transnational corporations might increasingly turn to domestic markets of host countries for raising capital to finance new investments, or to expand existing investments. 39/ This raises the question of the extent to which allowing foreign participation in domestic equity markets will influence both the amount and mode of foreign direct investment in the region.

29. Investment outflows from East, South and South-East Asia fell by a third in 1991, from the level reached in the previous year. The fall reflects primarily a significant decline of about 65 per cent in outflows from Taiwan Province of China between 1990 and 1991, in contrast with other home countries whose investments continued to rise. Although investment outflows from Taiwan Province of China decreased considerably in 1991, they were more than 30 times higher than average outflows during the first half of the 1980s. That economy also remains a net exporter of foreign direct investment, together with the Republic of Korea (fig. IV). The burst of outward investment during 1988-1990 in labour-intensive industries by transnational corporations from Taiwan Province of China was mainly in response to rising production costs and labour shortages at home. Large capital investments were made to establish new production facilities abroad (land acquisition, purchase of buildings, equipment etc.), particularly in the form of manufacturing plants in members of the Association of South-East Asian Nations (ASEAN) and China. In the future, investment outflows are likely to continue on an upward path. The principal motivation is the continuing desire to acquire technology and establish marketing and distribution channels in developed countries and to take advantage of expanding consumer markets and lower production costs in developing countries. 40/

Figure IV. Republic of Korea and Taiwan Province of China: foreign direct investment, 1981-1991



Source: Department of Economic and Social Development, Transnational Corporations and Management Division, based on United Nations Centre on Transnational Corporations, World Investment Directory 1992, vol. I. Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11) and Transnational Corporations and Management Division, foreign-direct-investment database.

30. By contrast, outflows from the other Asian newly industrializing economies such as the Republic of Korea and Singapore continued to grow in 1991. 41/ In addition, transnational corporations from a number of other Asian countries, such as Thailand - which only a few years ago did not have any investments abroad - are increasingly shifting assembly and other labour-intensive operations to neighbouring countries that have lower labour costs. 42/ Therefore, in spite of the fall in the overall level of investment outflows from East, South and South-East Asia in 1991, a network of investment and trade in manufactured goods between economies (especially Hong Kong, Malaysia, Singapore, Taiwan Province of China and Thailand) has been fostered (table 7). As a result, there is a growing interdependence of investments between China, East Asia and some member States of ASEAN, while South Asia has yet to play a major intra-regional role.

Table 7. Intra- and extraregional investment inflows, as reported by host economies in Asia, 1985-1987 and 1988-1990

(Percentage share of total)

Host economy	Intra-regional		of which: Japan		Extraregional	
	1985-1987	1988-1990	1985-1987	1988-1990	1985-1987	1988-1990
Bangladesh	10	11	6	4	90	89
China	77	72	12	12	23	28
India a/	11	8	10	5	89	92
Indonesia	51	50	31	18	49	50
Malaysia	38	67	19	25	62	33
Pakistan	1	2	1	2	99	98
Philippines	21	23	14	14	79	77
Republic of Korea	58	52	53	49	29	48
Singapore b/	10	47 c/	22	35 c/	90	53 c/
Taiwan Province of China	40	47	29	32	60	53
Thailand	55	77	38	45	45	23

Sources: Department of Economic and Social Development, Transnational Corporations and Management Division, based on United Nations Centre on Transnational Corporations, World Investment Directory 1992, vol. I, Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11) and Transnational Corporations and Management Division foreign-direct-investment database.

a/ Excludes foreign direct investments by non-resident Indians.

b/ Flows estimated as the difference in year-end values of foreign direct equity investments in two consecutive years.

c/ For 1988-1989.

2. Latin America and the Caribbean

31. In the Latin America and Caribbean region, the increase in average investment inflows since 1988 continued during 1991 and, apparently, 1992. 43/ The principal factors behind this increase seem to have been an improvement in the macroeconomic performance of several Latin American economies as a result of a successful enforcement of fiscal discipline, the restructuring of the external debt with private-sector creditors as well as the continuing trend towards economic liberalization in the context of which a number of countries also established stable and credible frameworks conducive to foreign direct investment. Furthermore, specific measures such as debt-equity swaps and privatization were instrumental in promoting large amounts of investment inflows by expanding the range of profitable investment opportunities in the region, with the latter becoming a relatively more important measure in promoting foreign direct investment in the early 1990s. However, despite major changes in government policies among many countries of the region, inflows continue to be highly concentrated in a handful of countries, primarily Argentina, Brazil, Chile, Mexico and, as of 1991, Venezuela. 44/

32. The trend towards liberalization of foreign-direct-investment policies in Latin America, evident since the late 1980s, particularly in the natural resources and services sectors, has enabled transnational corporations to engage in new activities in the region, while those in the manufacturing sector have had to modernize production to survive competition from imports due to trade liberalization, and to become internationally competitive. Overall, there has been a tendency for the rate of increase in new investment inflows in the natural resource and service sectors to surpass that of the manufacturing sector, where the lion's share of the accumulated stock of foreign direct investment in the region is found.

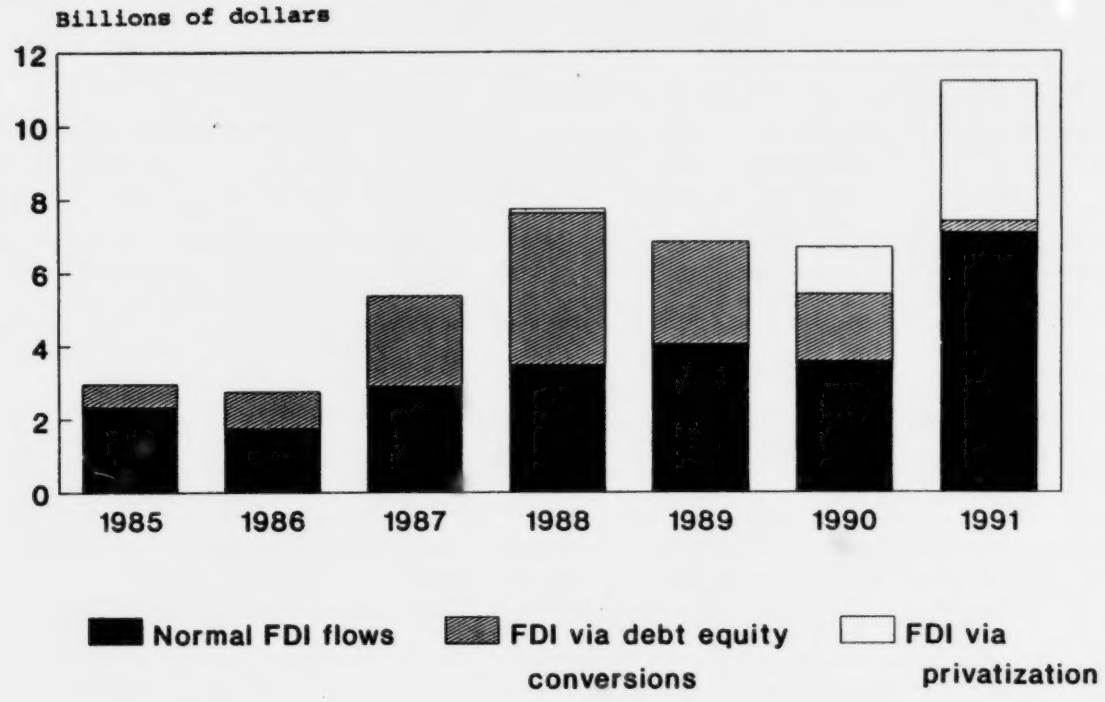
33. Countries of the region differ with respect to which type of foreign direct investment has been more important in explaining the increase in recent years. In Mexico, for example, recent foreign direct investment has been directed towards the restructuring of the motor vehicle industry, although the entrance of new transnational corporations in a number of services industries (tourism, telecommunications etc.) has also been significant. 45/ Chile provides a clear example of foreign direct investment in new export activities in natural resources (forestry, fish products, gold mining etc.), as well as large-scale expansion of traditional mining activities (copper) and in liberalized services (finance, airlines, telecommunications etc.). 46/ Recent increases in investment inflows in Argentina and Venezuela are also very much concentrated in liberalized service industries (telecommunications, air transport). 47/ By contrast, the limited inflows directed to Brazil in recent years have been geared towards the modernization of the manufacturing operations of foreign affiliates already operating in the country in order to face the import competition created by the new trade liberalization scheme. 48/ Hence, although various countries of the region have instituted many common policy instruments geared to attract increasing amounts of foreign direct investment, the degrees of success and the emerging patterns vary across countries.

34. In terms of policy perspectives, the general trend towards simplifying authorization and registration procedures; the lifting or reducing of sectoral

restrictions on foreign direct investment; the easing of limits on profit remittances, capital repatriation and technology payments; and the improving of the protection of intellectual property has continued. In addition, a significant incentive for encouraging foreign direct investment in the region, particularly to the larger and intermediate-sized countries, has been provided by programmes for the conversion of external debt obligations into investments, and the programmes for the privatization of State enterprises. However, there is an important transition taking place with respect to the relative importance of the policy instruments in the 1990s. As figure V suggests, during the late 1980s the policy instrument most utilized in major Latin American countries was debt-equity conversion programmes, in which external debt obligations are converted, directly or through intermediaries, into foreign direct investment. 49/ By the beginning of the 1990s, this instrument was losing relevance in many countries and was increasingly replaced by new programmes for the privatization of State companies, most notably in telecommunications and airlines, which offered new investment opportunities. 50/ In some countries, such as in Jamaica, some 90 per cent of the State-owned enterprises had been subject to privatization (making it the most heavily privatized developing country), of which almost one quarter involved foreign participation. Some 40 per cent of foreign investment inflows into Jamaica may be accounted for by the sale of privatized State enterprises to foreign enterprises. 51/

35. Although most of the major privatizations that took place in 1990-1991 involved primarily national private groups, there were significant transactions involving foreign investors, most notably in the cases of the telecommunications industry in Argentina, Mexico and Venezuela and in air transport in Argentina and Venezuela. It is noteworthy that all privatizations in the telecommunications and air-transport industries, except telecommunications in Mexico, involved foreign capital from Spain, particularly from the State-owned Telefónica de España and Iberia. In addition, in a limited number of cases, such as in Argentina, new foreign direct investment in 1990 and 1991 occurred largely through the simultaneous use of debt-equity swaps and privatization programmes - i.e., the purchase of State enterprises undergoing privatization was financed through the conversion of external debt obligations. Thus, special programmes continue to be responsible for much of the new inflows of investment to Latin America and the Caribbean, with the privatization of State enterprises assuming greater importance. An important consequence of this development was that new investment inflows tended to be in the form of acquiring existing assets as opposed to greenfield investments.

Figure V. Latin America: a/ foreign-direct-investment flows, 1985-1991



Sources: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations amd Management Division, World Investment Directory 1992, vol. IV. Latin America and the Caribbean (United Nations publication, forthcoming).

a/ Argentina, Brazil, Chile, Mexico and Venezuela only.

36. Whether the Latin America and Caribbean region will attract an increasing share of foreign direct investment in developing countries in the years to come remains to be seen and is likely to depend on the outcome of some crucial determinants. One of these has to do with the extent to which Brazil, once the largest recipient of foreign direct investment in the region, succeeds in stabilizing its economy and, as a result, may receive an increasing stream of investment. Another is the extent to which the North America Free Trade Agreement generates investment inflows to the region in preference to other regions. At the same time, there are some indications that, although the North America Free Trade Agreement is most likely to be beneficial for both Mexico and the United States (especially if newcomers to Mexico from countries other than the United States are obliged to meet rules of origin), other countries might be adversely affected by trade and foreign-direct-investment diversions. 52/ The extent of such a diversion (if it is to take place on a noticeable scale) will depend heavily on the degree of discriminatory access to the United States market. Clearly, however, Mexico has become more attractive as a low-cost sourcing base for United States transnational corporations and as a location for investors seeking access to the North American market.

37. Intra-regional investments also play a role in determining overall investment flows to a region. Such investments are an important component of investment inflows in a number of Asia and Pacific countries, prompted by the surge of investment not only from Japan but also from other countries of the region; 53/ by comparison, intra-regional foreign direct investment in Latin America is much less important. This is largely owing to the smaller size of aggregate outflows from the region, which over the period 1981-1991 amounted to $3.5 billion and represents only 11 per cent of the level of outflows from the Asia and the Pacific. 54/ These outflows emerged primarily from the larger economies of the region, such as those of Argentina, Brazil, Colombia, Mexico, Peru and Venezuela, and are concentrated in labour-intensive manufacturing and services (particularly banking and finance, real estate and wholesale and retail trade). 55/

38. Finally, it should be mentioned that the Latin America and Caribbean region has not benefited much from the growth of foreign direct investment from Japan and the Asian newly industrializing economies. As of fiscal year 1991, only around 7 per cent of foreign direct investment by Japanese transnational corporations in the manufacturing sector and less than 13 per cent of investment in all sectors had been directed to Latin America. Furthermore, although sales by Japanese manufacturing affiliates operating in Latin America rose from $2 billion to over $6 billion between 1982 and 1990, the region's share of global manufacturing sales of Japanese transnational corporations declined from 8 per cent to just over 3 per cent. 56/ The limited amount of Japanese investment directed to Latin America and the Caribbean in recent years is concentrated in a few special activities, the most significant being the maquiladora and motor-vehicle industries in Mexico, some mining, forestry and fishing projects in Chile, and Venezuela, where Japanese foreign direct investment accounts for some 3-4 per cent of total foreign direct investment. Hence, the region does not seem to play a strategic role in Japanese outward foreign direct investment, a fact that may also partly have something to do with the long geographical distance between Japan and the region and the psychic distance in terms of culture and language. Even in the Brazilian manufacturing sector, where the Japanese presence has been most evident

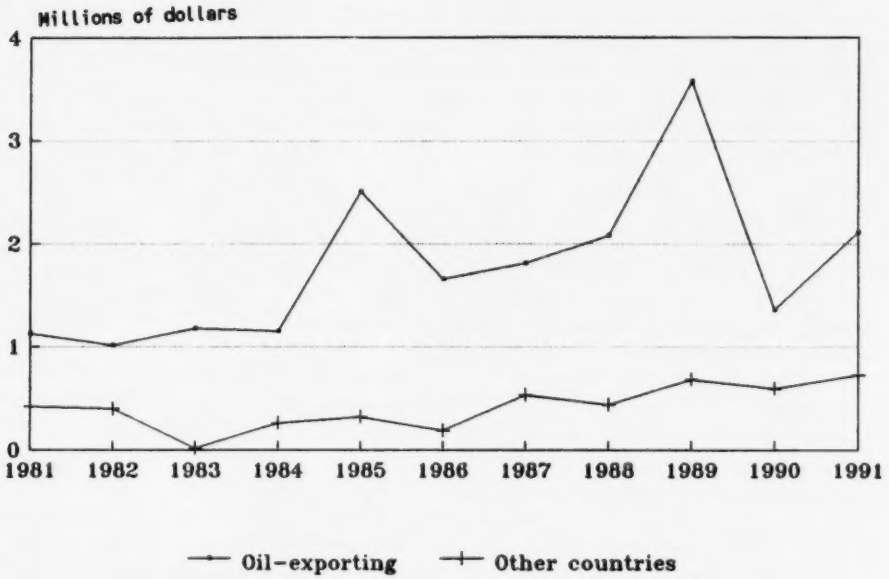
historically, the tendency has been to rationalize operations or to withdraw slowly. Similarly, rather small amounts of foreign direct investment from the Asian newly industrializing economies have been registered in the region. In the past few years, almost 100 Korean textile companies invested about $100 million in Central America to take advantage of the unused quotas of those countries in the United States market related to the Caribbean Basin Initiative. Taiwanese investors have also set up shops in the industrial parks bordering the Canal in Panama. 57/ It remains to be seen whether the revival of economic growth in the economies of the Latin American and Caribbean region, together with an improved macroeconomic environment and more open foreign-direct-investment frameworks, will significantly influence locational decisions by transnational corporations from Asia.

3. Africa

39. Investment inflows to Africa rose to $2.8 billion in 1991, an increase of 45 per cent from the level reached in 1990 (fig. VI). 58/ However, the level in 1991 was only slightly above the average level of inflows since 1985 of about $2.7 billion. The bulk of these investment flows is directed to oil-exporting countries, although the share of non-oil-producing countries has increased in recent years, reflecting the sizeable investment flows to Morocco. The presence of rich natural resources remains the principal locational advantage of Africa. The attractiveness of Africa continues to be negatively affected by slow economic growth, which remains well below the average for all developing countries. Hence, despite continued efforts to liberalize the regulatory framework for foreign direct investment and the introduction of "one-stop" centres in several countries, Africa has not succeeded in attracting sizeable investment flows. Some evidence of the increased outward investment activity on the part of transnational corporations from South Africa raises the question of the potential role of that country as a growth-pole for the southern African region.

40. Three quarters of all foreign direct investment in Africa in 1991 was directed to oil-exporting countries. Nevertheless, the average share of total investment flows to Africa accounted for by non-oil-producing countries increased from 17 per cent during the period 1986-1988 to 22 per cent during 1989-1991 (and the corresponding share of oil-exporting countries declined from 83 to 78 per cent). The increase in the share of the former reflects primarily a quadrupling of investment inflows to Morocco between these two time periods, attributed to domestic economic growth, combined with liberal foreign-direct-investment legislation and duty-free access to the European Community market of manufacturing goods produced in Morocco with a minimum of 40 per cent local content. 59/

Figure VI. Foreign-direct-investment flows to Africa, 1981-1991



Source: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division, World Investment Directory 1992, vol. III. Africa (United Nations publication, forthcoming).

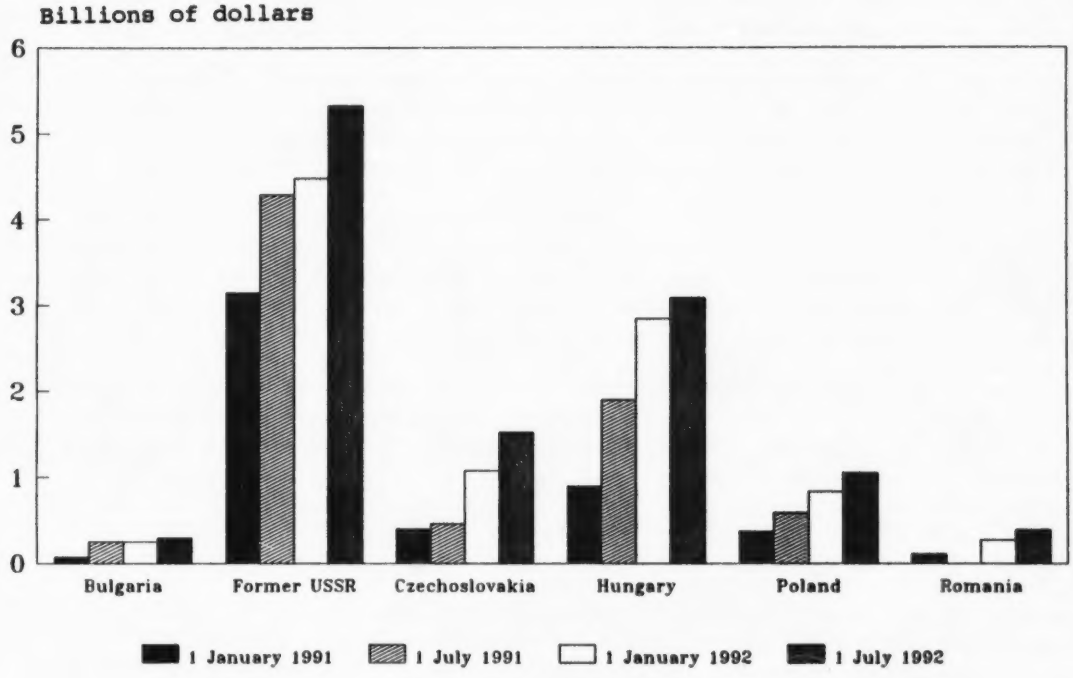
41. Foreign direct investment in natural resources continues to be an important locational advantage for many countries in sub-Saharan Africa. In 1991, for example, investment flows to Angola amounted to $670 million, which exceeded total cumulative investment flows received by that country between 1985 and 1990; most of these investments were in petroleum exploration and mineral mining. 60/ There is considerable potential for investment in oil exploration in sub-Saharan Africa. In order to exploit this potential, several countries are now offering more favourable contract terms to petroleum transnational corporations. Transnational corporations view investments in petroleum exploration and development as part of their strategy of global expansion in the face of growing demand for petroleum and oil products in Africa and other countries. 61/ Some countries have also encouraged foreign direct investment in the services sector with positive results; Mauritius, for example, has actively sought to attract foreign investors in banking and finance in recent years, aiming to become an offshore banking centre. Given the small size of the domestic markets of most countries in sub-Saharan Africa and low growth rates, investment flows to the manufacturing sector remain limited, despite continued liberalization of regulatory frameworks for foreign direct investment and the establishment of "one-stop" investment centres in several countries.

42. The increased investment outflows from South Africa in 1992, some of which may have been directed to the southern African region, could exert a positive impact on economic development in that region. 62/ It could be envisaged that investments from South Africa in member countries of the South African Development Coordination Conference and the Preferential Trade Area of Eastern and South African States, with which South Africa already has cooperation and trade agreements, could spur growth in a fashion similar to the role of Japanese investments in Asia. 63/ However, there are significant differences between the role of Japanese foreign direct investment in Asia and the potential role of South African foreign direct investment in the southern African region which make any straightforward comparisons difficult. For example, the principal locational advantage offered by the southern African countries is, with some exceptions, the availability of natural resources and cheap labour; but in both respects, South Africa itself is well endowed. The factors that prompted Japanese transnational corporations to invest in Asia in terms of the need to relocate labour-intensive manufacturing operations may not apply to transnational corporations from South Africa. Nevertheless, the possibility of increased interest of South African transnational corporations in the southern African region cannot be discounted, and this could have important implications for the growth and development of that region, once political relations are fully normalized.

C. Central and Eastern Europe

43. The number of foreign investment registrations and the amount of foreign capital committed in Central and Eastern Europe continued to grow in 1991 and the first half of 1992 (fig. VII), with Western Europe remaining the dominant source of investment. 64/ As a result, foreign direct investment in the region has increased as a proportion of worldwide foreign direct investment. However, it appears that - with the exception of the former Czechoslovakia and the Baltic republics - the pace of foreign direct investment in the region is

Figure VII. Cumulative foreign direct investment in Central and Eastern Europe, 1991-1992



Sources: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division and Economic Commission for Europe, World Investment Directory 1992, vol. II. Central and Eastern Europe (United Nations publication, Sales No. E.93.II.A.1), and the Economic Commission for Europe.

slowing down, and its distribution is not even among the countries of the region. However, all countries of the region place considerable emphasis on the role of foreign direct investment in their transition from centrally planned to market-oriented economies, as witnessed, for example, by the enactment of liberal legislation with respect to foreign direct investment and privatization programmes open to foreign capital.

44. During the first half of 1992, the number of foreign investment registrations in the countries of Central and Eastern Europe (excluding the former Yugoslavia) increased by 50 per cent over the level of 1 January 1992, to reach a total of 46,668 registered foreign affiliates with an estimated $11.7 billion of capital committed as of 1 July 1992 (table 8). Western European investors accounted for the largest share of foreign direct investment in the region, particularly in Hungary, Romania, Poland and the former USSR. Within the former USSR, investment continues to be concentrated in the Russian Federation, but investments in Estonia, Latvia and Lithuania are also increasing. 65/ Despite the dominance of Western Europe as a source of foreign direct investment, the Russian Federation and, to a much lesser extent, Ukraine have become significant investors in the Baltic States and the other republics of the former USSR; in these cases, however, the joint venture agreements concluded typically involve old production relationships that preserve existing supplier and customer links. 66/ Since, in the former USSR, enterprises located in Russia were the principal foreign investors (to the extent that such investment took place), 67/ Russian enterprises are now also investors abroad, especially in Western Europe; and this investment seems to be increasing. 68/

45. While there has been an overall increase in terms of the number of foreign investment registrations and foreign capital committed in the region, there has been a disparity in the distribution of this investment among the countries of the region, reflecting differences in the speeds with which regulatory regimes for foreign direct investment are being liberalized, the rates of success of economic, institutional and political reforms, and fundamental locational advantages. The relatively advanced transformation process in countries such as the former Czechoslovakia, Hungary and Poland, combined with their geographical proximity to the European Community and their increasingly favourable access to the Western European market following the conclusion of association agreements with the European Community, have placed these countries at a more advantageous position to attract foreign direct investment, particularly investment geared towards the export of agricultural products, textiles, steel and chemicals. 69/ A differentiated pattern of foreign direct investment is also observable within the former Union of Soviet Socialist Republics, with the Asian republics lagging behind the European republics and, in particular, the Russian Federation. In fact, Hungary and the republics of the former USSR as a group have been the most successful in the region in terms of attracting foreign investment.· Together, they accounted for approximately 72 per cent of the total foreign capital commitments to the economies of Central and Eastern Europe (excluding the former Yugoslavia) and about 41 per cent of the total number of registered foreign affiliates.

Table 8. Cumulative number of foreign investment registrations in Central and Eastern Europe, by host country, 1 January 1992 and 1 July 1992

Host country	1 January 1992	1 July 1992
Bulgaria	900	1 800
Czechoslovakia (former)	4 000	4 800
Hungary	9 117	11 196
Poland	4 796	7 648
Romania	8 022	13 432
Union of Soviet Socialist Republics (former)	4 208	7 792
of which: Commonwealth of Independent States a/	2 593	4 632
Total	31 043	46 668

Sources: Department of Economic and Social Development, Transnational Corporations and Management Division, based on Transnational Corporations and Management Division and ECE, World Investment Directory 1992, vol. II. Central and Eastern Europe (United Nations publication, Sales No. E.93.II.A.1); Economic Commission for Europe database.

a/ Excluding Estonia, Latvia, Lithuania and Georgia.

46. Continuing political instability, lack of convertibility of currencies, rapid decline in domestic production and employment and the loss of traditional export markets are significant problems for an expanded role of transnational corporations in this region. Furthermore, frequent changes in the legal and regulatory framework have contributed to the uncertainties faced by investors. As a result, many countries of the region have not been able to attract large amounts of foreign direct investment. While the number of registrations of foreign affiliates has increased rapidly, the value of capital commitments has grown at a much slower pace. Hence, apart from some well-publicized cases of investments by large transnational corporations, investment projects in the region continue to be small- and medium-sized, ranging mostly from $45,000 to $1.5 million. 70/ Furthermore, while the recent political and economic reforms have increased the interest of foreign firms to invest, the volume of actual investments so far remains low in comparison to commitments, owing partly to the long lead time necessary to implement investment projects. It may also be an indication that some foreign investors hold back their investments in the face of continuing political and economic instability, or that the registered foreign investment projects merely serve as tax shelters or conduits to benefit from favourable tax treatment granted to foreign affiliates. 71/ By 1991, the ratio of operational to registered joint ventures was estimated to be 41 per cent in the case of Hungary and 35 per cent in the former USSR. 72/ By 1992, the ratio increased to 40 per cent in the former USSR, suggesting an increasing trend in the number of projects actually realized. 73/

47. In their transition from centrally planned to market-oriented economies, all countries of the region are placing considerable emphasis on foreign direct investment as a means of acquiring much needed capital, know-how and technology (including environmentally sound technology) and new export opportunities. For that purpose, all countries have enacted liberal legislation with respect to foreign direct investment, including privatization. Clearly, the privatization process in the countries of the region can benefit from the participation of transnational corporations, especially in light of the scarcity of new domestic investment capital and managerial skills.

48. Despite the small amount of actual foreign investments implemented and their small share of domestic investment activity, foreign affiliates - most of which are greenfield investments, largely in the form of joint ventures with domestic partners - have contributed to structural changes and economic transformation through stimulating the development of local entrepreneurship and the introduction of innovations in business practices. Joint ventures have been particularly instrumental in these respects. This is shown in the better record of sales, profits and foreign-currency earnings per employee of joint ventures in comparison to wholly domestically owned enterprises. 74/

49. The sectoral distribution of foreign direct investment in the region also provides evidence of the important role of transnational corporations in triggering structural changes. Manufacturing is the single largest sector of foreign investment activity in most countries of the region, particularly in high-technology industries (computer and computer-related technologies) and telecommunications, where local expertise is lacking. 75/ Although the other sectors of the economy so far have attracted relatively little foreign investment, several transnational corporations have expressed interest in exploring investment opportunities in petroleum exploration and exploitation in the former Union of Soviet Socialist Republics, which are expected to be a dominant source of foreign-currency earnings for the new republics. 76/ The tertiary sector has also been a significant area of investment by transnational corporations in the region, particularly in Hungary. Given that services were traditionally neglected in centrally planned economies, foreign direct investment in services and, in particular, business services, form an important and essential part of the contribution to the transition process. 77/

50. The important role of transnational corporations in the transition process is also seen in their concentration in export-oriented industries. This has helped to integrate the region more rapidly into the world economy and to increase the region's foreign exchange earnings. In Hungary, for example, by forming part of the regional network of their parent firms in which cross-border production processes at different points of the value-added chain are linked, foreign affiliates have played a significant part in the country's export performance, accounting for more than 16 per cent of non-rouble exports. 78/ Through regional corporate networks, host countries obtain access to marketing and distribution facilities, particularly in the Western European market, thereby enhancing the integration of these countries into the Western European trade and foreign-direct-investment cluster and providing an incentive for closer association with the European Community. The perception of the closer association with the European Community, including possible membership of these countries, in turn serves as a stimulus for investment by

transnational corporations that are motivated by long-term strategic considerations. 79/

51. The importance of the region as part of a regional core-network strategy of transnational corporations and its potential role as a region for domestic market-oriented investment is reflected in the continuing growth of foreign-direct-investment inflows, despite the recession in the developed home countries and the deteriorating economic situation in host countries. However, the slower pace of investment growth is a matter of concern for the countries of the region, as is the gap between the number of committed and operational joint ventures, since it implies that the urgently needed inflow of foreign capital required to assist in the transition process is not forthcoming. 80/ Hence, while the countries of Central and Eastern Europe look to foreign direct investment to play a major role in their macroeconomic stabilization and the micro-economic, technological and financial transformation of their economies, transnational corporations appear to view stabilization and transformation as preconditions for major investment. The resolution of the dilemma poses a major challenge for the countries of the region.

III. SUMMARY AND CONCLUSIONS

52. Despite the decline in the world-wide flows of foreign direct investment in 1991 and of inflows to the developed countries, the inflows to all regions of the developing world increased in absolute and relative terms. This significant feature of foreign-direct-investment flows in 1991 may be attributed, on the one hand, to continued economic uncertainty in the developed countries, and on the other hand, the maintenance or resurgence of strong economic performance in a wide spectrum of developing countries in Asia and Latin America, their control of vital natural resources in Africa and their continuing efforts to liberalize and privatize. The general trend towards liberalization and privatization has also been evident in the region of Central and Eastern Europe whose level of inflows continued to grow, largely in response to long-term corporate strategies adopted in light of expectations of future growth in the region. Privatization has expanded the range of profitable investment opportunities for transnational corporations in both Latin America and Central and Eastern Europe.

53. The decline in world-wide flows of foreign direct investment in 1991 represents the first downturn since 1982 and occurred largely because of recessionary conditions in major industrialized countries and structural weaknesses in the financial systems in a number of countries which rendered finance capital for foreign direct investments more difficult to obtain or available only at increased costs. These factors made transnational corporations maintain a cautious stance and to concentrate on improving efficiency of existing investments, rather than adding to capacity or undertaking new investments. The decline in world-wide flows of foreign direct investment in 1991 is seen in the major decrease in outflows from Japan and, to a lesser extent, Western Europe, and also in the much slower pace of mergers and acquisitions as a mode of foreign-direct-investment activity in the early 1990s in response to the changing macroeconomic conditions and corporate strategies.

54. The slow-down of economic activity and the declining profitability of investments since 1980s is reflected in the lower share of reinvested earnings in foreign-direct-investment outflows of the major home countries. In terms of inflows, however, reinvested earnings still constitute a significant component of foreign direct investment in developing countries which points to the greater relevance of domestically raised capital as a component of foreign direct investment in these countries, unlike in the developed countries where foreign direct investment is financed more from external sources.

55. Despite the decline in flows in 1991, however, the importance of the activities of transnational corporations in the world economy continued to increase as net additions to the world-wide stock of foreign direct investment and their pace of growth have been faster relative to exports, domestic output and domestic investment.

56. A key issue that needs to be addressed is whether the increasing importance of developing countries and Central and Eastern Europe as recipients of foreign direct investment, both in absolute and relative terms, is likely to be sustained. The answer is dependent on the outcome of crucial determinants over the longer term. On the one hand, the expectations for an upturn in economic growth rates may prompt transnational corporations to re-focus their activities in the developed countries, where they already have large stocks of accumulated foreign direct investment. On the other hand, the prospects of improved locational advantages in other parts of the world - such as the improvement of the political and economic situation, coupled with the availability of lower-cost skilled labour, in Central and Eastern Europe, and the continuing trend towards liberalization and privatization - may accelerate investment inflows into those regions. Moreover, if economic performance is further strengthened in the Latin America and Caribbean region, and if countries in the Asia and the Pacific region sustain their growth, developing countries as a group may increase their attractiveness for foreign direct investment. On balance, it is hard to predict whether these regions can sustain their increasing share of foreign direct investment, but in all likelihood the absolute level of flows will continue to increase through the 1990s.

57. A related question is whether the downturn in investment flows in 1991 foreshadows a permanent reduction or deceleration in foreign-direct-investment flows over the 1990s - an issue addressed in another report before the Commission (E/C.10/1992/3). The expectations are that, although there will always be cyclical oscillations, several structural changes in the world economy, in combination with a number of anticipated policy-related changes, are likely to contribute to an upward trend in foreign-direct-investment flows during the 1990s.

Notes

1/ A survey undertaken by Japan's Export-Import Bank of 115 major Japanese companies indicated that, although they would direct the biggest single share (26 per cent) of their foreign investment to the European Community between early 1992 and March 1994, the member countries of the Association of South East Asian Nations come close behind. Asia plus Oceania will absorb half of the total. See Anthony Rowley, "Japan looks closer to home", Far Eastern Economic Review (16 January 1992), p. 40; and David Dodwell, "Trade surplus likely to fuel Japanese investment in the Pacific", Financial Times (3 December 1991).

2/ See Transnational Corporations from Developing Countries: Impact on Their Home Countries (United Nations publication, forthcoming). A significant proportion of foreign direct investment by developing countries may not represent genuine investment - that is, transfer of capital, skills, know-how and control. For example, more than one third of foreign direct investment by developing countries originates from offshore investment sites and tax havens such as Bermuda, the Cayman Islands, Liberia, the Netherlands Antilles and Panama. The exclusion of these countries reduces the outward investment stock of developing countries to $80 billion in the late 1980s. Foreign direct investment by several oil-exporting countries may also not fall under the definition of transnational corporate activity.

3/ Ibid.

4/ In SDR terms, the rate of annual growth of world-wide outflows, gross domestic product, gross domestic investment, exports, sales, royalty-and-fees receipts during the period 1986-1990 were 7 per cent, 6 per cent, 7 per cent, 3 per cent, 12 per cent and 18 per cent, respectively. Hence, world-wide outflows grew more than twice as fast as world-wide exports and kept pace with world-wide gross domestic product and gross domestic investment. However, the rate of annual growth of royalties-and-fees receipts was almost three times as fast as that of world-wide outflows. However, world-wide sales of transnational corporations grew twice as fast as world-wide gross domestic product and gross domestic investment and four times faster than world-wide exports.

5/ See Organization for Economic Cooperation and Development, OECD Economic Outlook (Paris, various issues), table on rates of return on capital in the business sector.

6/ It may be presumed that, in the developed countries, profits earned from foreign-direct-investment activities in one country or area may be used to finance foreign direct investment in another country or area. This may also hold true of the other components of foreign direct investment, equity capital and short- and long-term capital.

7/ Profit rates are defined here as the share of net income to total income. See United States, Department of Commerce, United States Direct Investment Abroad: Operations of US Parent Companies and their Foreign Affiliates (Washington, D.C., Government Printing Office, September 1992).

Notes (continued)

8/ For a full analysis of foreign-direct-investment trends in the developed countries, including developments related to the legal framework, see World Investment Directory 1993, vol. III. Developed Countries (United Nations publication, forthcoming).

9/ To take the United States as an example, take-over activities completed in 1991 amounted to $116.7 billion, representing a decline from $169.4 billion in 1990 and the $263.8 billion record in 1988. Where large-scale takeovers are undertaken, they tend to be largely domestic. See Martin Dickson, "Mergers and acquisitions: steady stream of smaller deals", Financial Times (11 June 1992).

10/ The value of foreign takeovers by the largest 50 French firms declined by 24 per cent, to 80 billion French francs by 1991, putting an end to four years of straight growth. See William Dawkins, "Exports revival", Financial Times (22 June 1992).

11/ International Cooperation Agreements and International Mergers and Acquisitions in the 1980s (United Nations publication, forthcoming).

12/ "Japanese capital flows: inward bound", The Economist (8 February 1992); "Japan's direct investment slows", The Wall Street Journal (8 June 1992).

13/ John Rutter, "Recent trends in international direct investment" (Washington, D.C., International Trade Administration, United States Department of Commerce, August 1992), mimeo.

14/ Frances Williams, "A paragon is humiliated", Financial Times Survey (7 May 1992).

15/ John Rutter, "Recent trends in international direct investment" (Washington, D.C., International Trade Administration, United States Department of Commerce, August 1992), mimeo.

16/ The United States affiliates of Japanese companies are cautious about investment in plant and equipment and long-term plans, because of low profitability. Sixty-three per cent of 264 Japanese affiliates in the United States cited earnings as their biggest concern, and half plan no change in future capital spending change; 19 per cent plan cuts. See James Sterngold, "Japanese shifting their investments back toward home", The New York Times (22 March 1992), and "Japanese wary on U.S. operations", The Wall Street Journal (9 June 1992).

17/ See Lionel Barber, "Big stake in EC's future", Financial Times Survey: Japan and The European Community (13 November 1992); Michiyo Nakamoto, "Investment in manufacturing: time for rigorous assessment", Financial Times Survey (7 May 1992); Daniel Green, "Fears over long-term impact", Financial Times Survey.

Notes (continued)

18/ Some examples of new alliances are those established between Renault, once a symbol of French State industry, and Volvo, the Swedish car maker; the stakes taken in Bull, the State-owned computer group, by Nippon Electric Corporation of Japan and International Business Machines (IBM) of the United States, and the share swap being negotiated between Banque Nationale de Paris and Dresdner Bank of Germany. See William Dawkins, "Revising the borders", Financial Times (22 June 1992).

19/ Privatization has been placed at the top of the agenda in Italy. See Robert Graham, "The Italian auction begins", Financial Times (20 July 1992); Heig Simonian, "Privatisation encounters barriers", Financial Times (7 July 1992); Tim Carrington, "Italy braces for privatization measures", The Wall Street Journal (12 June 1992).

20/ For example, the slow pace in which the privatization programme has been implemented in Greece in the past has resulted in limited investments by foreign entities. The exception was Heracles General Cement, Europe's biggest cement exporter, sold for 124 billion drachmas to a joint venture between Calcestruzzi (52.5 per cent), the construction arm of Italy's Feruzzi group, and the National Bank of Greece. In addition, although the Government of Portugal has pursued an ambitious programme of economic liberalization and privatization (with the dismantling of State monopolies and the liberalization of financial markets), the State continues to play a dominant role in the economy. Foreign control of privatized companies is not generally authorized, while foreign participation must be limited to 40 per cent of the voting capital. Hence, in all but two privatizations, foreign participation has been limited to between 2 and 35 per cent. See Kerin Hope, "Privatisation: quickening pace of sales", Financial Times (15 June 1992), and Andrew Jack, "Privatisation: the state prevails", Financial Times (4 March 1992).

21/ The number of Swedes employed by foreign companies has also tripled. An estimated 135 Swedish companies, employing 40,000 workers, were bought by foreign concerns since the late 1980s.

22/ Robert Taylor, "Sweden to launch strategy to attract foreign investors", Financial Times (18 February 1992).

23/ For example, in Spain, the path to convergence with leading European Community economies and the Government's determination to be a founding member of European economic and monetary union could result in the elimination of such obstacles to growth of foreign investment as the dismantling of the monopoly in the pharmaceutical industry, the end of protection in various service industries and the discontinuation of all other forms of capital control and investment obstacles that confront foreigners. See Peter Bruce, "Comes the reckoning", Financial Times Survey (1 June 1992), and Peter Bruce, "The strain and pain in Spain", Financial Times (27 May 1992).

24/ See World Bank, World Bank Debt Tables 1992-93, vol. I. Analysis and Summary Tables (Washington, D.C., 1992).

Notes (continued)

25/ See From the Common Market to EC92: Regional Economic Integration in the European Community and Transnational Corporations (United Nations publication, Sales No. E.93.II.A.2); Regional Economic Integration and Transnational Corporations in the 1990s: Europe 1992, North America and Developing Countries (United Nations publication, Sales No. E.90.II.A.14).

26/ Of 18 cases of foreign direct investment by companies engaged in the production of automobiles, engineering products, chemicals and pharmaceuticals, only three cases were concerned with exporting from the domestic market, and in only one was the investment motivated by exports to the European Community (and Latin America). For 17 of the 18 cases, the main objective for foreign direct investment was import-substituting, made in response to the imposition of high tariffs and import quotas. See P. J. Buckley and P. Artisien, "Policy issues of intra-EC direct investment, British, French and German multinationals in Greece, Portugal and Spain with special reference to employment effects", in Multinationals and the European Community, John H. Dunning and P. Robson, eds., (Oxford, Blackwell, 1987).

27/ Even export-oriented foreign direct investment in developing countries that could have been negatively affected by the single European market, owing to possible investment diversion to the southern members of the European Community (Greece, Portugal and Spain), did not suffer because of the rising costs of labour and stricter pollution standards in the latter. See Jamuna Prasad Agarwal, "Effect of EC92 on foreign direct investment in developing countries", Transnational Corporations, vol. II (United Nations publication, forthcoming).

28/ However, although the overall effect of the single market is very small, its particular effect on countries like Cyprus, Malta, Mauritius and Tunisia is almost certainly substantial. See United Nations, Department of Economic and Social Development, Transnational Corporations and Management Division, From the Common Market to EC92: Regional Economic Integration in the European Community and Transnational Corporations, (United Nations publication, Sales No. E.93.II.A.2); Vincent Cable, "1992 and its implications for developing countries" (London, Commonwealth Secretariat, 1988), mimeo.

29/ See From the Common Market to EC92: Regional Economic Integration in the European Community and Transnational Corporations (United Nations publication, Sales No. E.93.II.A.2).

30/ For a full analysis of foreign-direct-investment trends in Asia and the Pacific, including developments related to the legal framework, see World Investment Directory 1992, vol. I. Asia and the Pacific (United Nations publication, Sales No. E.92.II.A.11); and Transnational Corporations and Management Division foreign-direct-investment database.

31/ "Japanese prepare for the Vietnam gold rush", The Wall Street Journal (21 February 1992). As of 31 August 1992, Taiwan Province of China was the largest foreign investor in Viet Nam. See Alexander Nicoll, "Vietnam looks for gains from US election", Financial Times (3 November 1992), and Victor Mallet, "Cambodians rush headlong to market", Financial Times (28 November 1991).

Notes (continued)

32/ Consulate General of India, unpublished data. See also "Foreign investment: more, but still not enough", Financial Times (26 June 1992).

33/ Foreign direct investment on a contract basis differs from investment actually made. In 1991, for example, foreign direct investment totalling $4.4 billion was actually made from the $12 billion contracted.

34/ James McGregor, "Foreign firms in China are preparing for expected consumer spending surge", The Asian Wall Street Journal Weekly (23 March 1992); Robert Thomson, "Honda announced first motorcycle venture in China", Financial Times (27 May 1992).

35/ It should also be noted that investment inflows did not decline after the Tiananmen Square incident in 1989, which might suggest that these investments would have increased sooner, were it not for the incident.

36/ Michiyo Nakamoto, "Motorola builds semiconductor plant in China", Financial Times (19 May 1992).

37/ "Bank Negara signals shift in foreign investment focus", East Asian Executive Reports (May 1992), pp. 13-14; Jon Liden, "Foreign investment: a more selective approach", Euromoney (Malaysia supplement) (August 1992), pp. 51-53, 56-57.

38/ "Japanese investment in Asia: the second wave", The Economist (7 November 1992), pp. 87-88.

39/ These would not be reflected in foreign-direct-investment data compiled for the balance of payments.

40/ Investment outflows on an approval basis show an increase between 1991 and 1992 of 7 per cent. See Ministry of Economic Affairs, Investment Commission, "Statistics on overseas Chinese and foreign investment, technical cooperation, outward investment, outward technical cooperation" (August 1992).

41/ Korea has also sparked the development of a sports-shoe industry that employs 30,000 locals in Indonesia. See Urban C. Lehner, "With Japan's backing, Indonesia gains a larger role in regional economy", The Wall Street Journal (10 January 1992).

42/ "Thai group invests $1 billion in China", Financial Times (7/8 November 1992). Thai firms have also begun to invest in Laos and other countries in the region.

43/ For a full analysis of foreign-direct-investment trends in Latin America and the Caribbean, including developments related to the legal framework, see World Investment Directory 1992, vol. IV. Latin America and the Caribbean (United Nations publication, forthcoming).

44/ Pedro Aspe, Andres Bianchi and Domingo Cavallo, Sea Changes in Latin America (Washington, D.C., Group of Thirty, 1992).

Notes (continued)

45/ Michael Mortimore and Torben Huss, "Industrial modernization in Mexico: results of a questionnaire administered to the largest foreign-owned companies in the manufacturing sector during May/June 1990" (Santiago, Economic Commission for Latin America and the Caribbean, 12 November 1991); Wilson N. Perez, Foreign Direct Investment and Industrial Development in Mexico (Paris, OECD Development Centre, 1990); Foreign Direct Investment and Industrial Restructuring in Mexico (United Nations publication, Sales No. E.92.II.A.9); Kurt Unger, Las Exportaciones Mexicanas ante la reestructuración Industrial Internacional (Mexico, El Colegio de Mexico/Fondo de Cultura Económica, 1990); Mauricio de Maria y Campo, "Reestructuración y desarrollo de la industria automotriz mexicana en los años ochenta: evolución y perspectivas", Estudios e Informes de la CEPAL, No. 83 (Santiago, Chile, 1992), and Secretaria de Comercio y Fomento Industrial, UNCTAD and UNDP, Mexico: Una Economia de Servicios (UNCTAD/ITP/58).

46/ Roberto Behrens, "Inversion extranjera y empresas transnacionales en la economía chilena: el papel del capital extranjero y la estratégia nacional de desarrollo", Estudios e Informes de la CEPAL, No. 86 (Santiago, Chile, 1992); Patricio Rozas, "Inversion extranjera y empresas transnacionales en la economía de Chile: proyestos de inversión y estratégias de las empresas transnacionales", Estudios e Informes de la CEPAL, No. 85 (Santiago, Chile, 1992); and Ricardo Ffrnech-Davis, Patricio Leiva and Roberto Madrid, "La apertura comercial en Chile", Estudios de política comercial, No. 1 (New York, UNCTAD, 1991).

47/ See, among others, Alejandra Herrera, "La privatización de la telefonia argentina", Revista de la CEPAL, No. 47 (August 1992), pp. 163-176.

48/ Ricardo Bielschowsky, "Transnational corporations and industrial modernization in Brazil: results of a questionnaire administered to the largest foreign-owned companies in the manufacturing sector during November 1991/January 1992" (Santiago, Chile, ECLAC, 14 September 1992), mimeo; and Wilson Fritsch and Gustavo Franco, Foreign Direct Investment in Brazil: Its Impact on Industrial Restructuring (Paris, OECD Development Centre, 1991).

49/ Michael Mortimore, "Debt-equity conversion", CEPAL Review, No. 44 (August 1991), pp. 79-96; Debt-Equity Swaps and Development (United Nations publication, forthcoming).

50/ In the case of Chile, this process began several years earlier.

51/ Maurice Odle, "Foreign investment as part of the privatisation process", Transnational Corporations, vol. II (United Nations publication, forthcoming).

52/ United States, International Trade Commission, The Likely Impact on the United States of a Free Trade Agreement with Mexico (Washington, D.C., USITC Publication 2353, February 1991), p. viii; and Refik Erzan and Alexander Yeats, "Free trade agreements with the United States: what's in it for Latin America?", World Bank Policy Research Working Papers, No. 827 (Washington, D.C., January 1992).

Notes (continued)

53/ See preceding section.

54/ Data do not include outflows from Mexico which are not available.

55/ See World Investment Directory 1992, vol. IV. Latin America and the Caribbean (United Nations publication, forthcoming).

56/ Calculated from Ministry of International Trade and Industry, 1982 Benchmark Survey on Japanese Companies' Foreign Activities: Compendium on Foreign Activity Data (Tokyo, Toyo Keizai, 1986); and 1990 Benchmark Survey on Japanese Companies' Foreign Activities: Compendium on Foreign Activity Data (Tokyo, Toyo Keizai, 1992).

57/ See "Asian tigers leap into Central America", Business Latin America (16 December 1991), pp. 401-402; and "Bienvenidos, invasores", America Economia, No. 65 (September 1992), p. 77.

58/ For a full analysis of foreign-direct-investment trends in Africa, including developments related to the legal framework, see World Investment Directory 1992, vol. V. Africa and Western Asia (United Nations publication, forthcoming).

59/ Claude Clement, "U.S. and Morocco expand commercial ties: Morocco gives priority to tourism development", Business America, 112 (4 November 1991), pp. 2-8; and "Morocco's investment rules", Middle East Executive Reports, 113 (November 1990), pp. 16-21.

60/ Caroline Southey, "The oil industry: key to Angola's survival since independence", Financial Times (12 May 1992); Michael Griffin, "Angola-peace opens up new prospects for investment", Multinational Business, No. 3 (Autumn 1991), pp. 30-36; "Industry poised to boost production on Angola/Cabinda acreage", Oil and Gas Journal, 90 (10 February 1992), pp. 36-37. A record level of petroleum exploration activity in Angola was recorded in 1991. Several transnational petroleum corporations (e.g., Chevron, Elf, Texaco, Petrofina and Agip) have been active in the country.

61/ Martin Quinlan, "Energy finance: Africa woos the energy giants", Euromoney, Energy Finance Supplement (June-July 1990), pp. 63-64.

62/ Philip Gawith, "South Africa investment up - but so are the outflows", Financial Times (26 November 1992); and Patti Waldmeir, "Pretoria acts on exchange control curbs", Financial Times (1 December 1992). Some of the South African transnational corporations that have recently invested abroad include Sappi, Mondi and First National Bank. There is also a proposed takeover of Del Monte Foods International by the Royal Group and Anglo American.

63/ See also Stephen Vascianne, "The PTA Charter on Multinational Industrial Enterprises", Transnational Corporations, 1 (August 1992), pp. 97-110.

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64/ For a full analysis of foreign-direct-investment trends in Central and Eastern Europe, including developments related to the legal framework, see World Investment Directory 1992, vol. II. Central and Eastern Europe (United Nations publication, Sales No. E.93.II.A.1).

65/ See World Bank, Foreign Direct Investment in the States of the Former USSR (Washington, D.C., 1992).

66/ Ibid., p. 20. According to the national statistics of Latvia and Lithuania, the Russian Federation's share of registered foreign affiliates was 32 per cent in both countries. The share of registered foreign affiliates of corporations headquartered in Ukraine was 4 per cent in Lithuania and 3 per cent in Latvia.

67/ See The East-West Business Directory 1991-1992 (United Nations publication, Sales No. E.92.II.A.20).

68/ For example, a Moscow-based firm recently purchased part of the German company United Cellulose Works of Pirna (Saxony). See German Information Center, "First Russian firm buys Eastern German company", The Week in Germany (16 October 1992), p. 5.

69/ The flow of foreign direct investment to the former Czechoslovakia will probably be affected by the break-up of the country. According to the Czech Republic Industry Minister, approximately 20 per cent of foreign firms had cancelled ongoing negotiations with Czech firms and about 40 per cent had put talks on hold because of the political uncertainties (see Bureau of National Affairs, Eastern Europe Reporter, 2 (20 July 1992), p. 592). The agreement on the dissolution of the country concluded on 20 July 1992 stipulates, however, that the two States will maintain close cooperation in foreign policy, defence and trade, including the creation of a free-trade zone ensuring the free flow of labour and capital. At present, Slovakia has received less than 20 per cent of total foreign direct investment in the former Czechoslovakia (see Bureau of National Affairs, Eastern Europe Reporter, 2 (3 August 1992), p. 650).

70/ For example, in terms of capital committed, Volkswagen AG is investing $6.6 billion in the former Czechoslovakia, Fiat is investing $2 billion in Poland, Chevron invested $2 billion in Kazakhstan, General Motors is investing $289 million in Hungary and Pilkington is investing $140 million in Poland. See World Investment Directory 1992, vol. II. Central and Eastern Europe (United Nations publication, forthcoming), as well as Wall Street Journal (19 February 1992).

71/ Ibid.

72/ See Katherin Marton, "Foreign direct investment in Hungary", Transnational Corporations, 1 (January 1993); World Bank, Foreign Direct Investment in the States of the Former USSR (Washington, D.C., 1992).

Notes (continued)

73/ See World Bank, Foreign Direct Investment in the States of the Former USSR (Washington, D.C., 1992).

74/ See Nicolas Denton, "A kiss of life from across the border", Financial Times (4 December 1992).

75/ See, for example, John Murray Brown, "Turkey gets Central Asia on the phone", Financial Times (4 December 1992).

76/ See Leyla Boulton, "The lure of oil's final frontier", Financial Times (6 March 1992).

77/ See, for example, Paul Betts and Leyla Boulton, "With western help, a wing a prayer", Financial Times (10 April 1992).

78/ Marton, loc. cit.

79/ For example, the global rivalry between Coca-Cola and Pepsi-Cola and between Ford and General Motors seems to have been carried over into the Hungarian market. See Bureau of National Affairs, Eastern Europe Reporter, Special Report: Hungary, 2 (20 July 1992), pp. 613-616.

80/ The capital needed for privatizations in Latin America, South-east Asia and Central and Eastern Europe has recently been estimated at $500 billion. A similar amount is required for the former Soviet Union. See William B. Rhodes, Vice-Chairperson of CitiBank, in The Economist (12 September 1992), p. 21.

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GENERAL DISCUSSION ON TRANSNATIONAL CORPORATIONS IN THE WORLD ECONOMY AND TRENDS IN FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

Growth of foreign direct investment in the 1980s: trend or bulge?

Report of the Secretary-General

SUMMARY

Historically, foreign-direct-investment flows have followed an upward trend with some year-to-year fluctuations. During the second half of the 1980s, however, investment flows surged at an average annual rate of growth of 28 per cent, the highest ever experienced. Fluctuations in investment flows concur with the expansion of the world economy after 1982 and the ensuing recession, or slow growth, after 1989. In the past, fluctuations in investment flows have also responded to cyclical fluctuations in the growth rate of the world economy after a time lag.

Nevertheless, cyclical factors alone do not explain the size of the surge in investment flows between 1985 and 1990. Other factors that have played a role during that period relate to the response of transnational corporations to policy changes and to structural changes in the world economy. Policy-related factors include trade liberalization, changes in exchange rates, the liberalization of foreign-direct-investment regimes, privatization, non-tariff barriers and regional integration schemes. Structural factors include the existence of a stock of foreign direct investment already in place and the emergence of an integrated international production system. Policy-related and structural factors suggest that investment flows are likely to continue to increase, although cyclical factors that led to the fall in these flows in 1991 continue to exercise an influence.

* E/C.10/1993/1.

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INTRODUCTION

1. In concluding its general discussion at its eighteenth session on transnational corporations in the world economy and trends in foreign direct investment in developing countries, the Commission on Transnational Corporations requested the Secretariat to continue its work on foreign direct investment and the role of transnational corporations in development and to submit reports dealing with those matters to the Commission at its nineteenth session. The present report is in response to that request. The Commission has also before it reports on trends in foreign direct investment (E/C.10/1993/2), on the emergence of integrated international production (E/C.10/1993/4) and on the universe of transnational corporations (E/C.10/1993/5), all dealing with aspects of the matters mentioned above.

2. Foreign-direct-investment outflows grew rapidly during the second half of the 1980s, reaching a peak of $234 billion in 1990 and falling by 23 per cent in 1991. Investment flows during the past two decades have followed an upward trend with year-to-year fluctuations. The exclusion of Japan, whose outward investments increased consistently from $6 billion to $48 billion between 1985 and 1990, does not alter that trend. Two periods of surges followed by subsequent falls in investment flows clearly stand out: during 1978-1981, investment flows increased at an average annual rate of 11 per cent, and during 1986-1990, investment flows rose at an average annual rate of 28 per cent. The fall in 1991 (which may continue in subsequent years) has marked the end of the most rapid expansion of investment flows ever experienced, surpassing by far the previous surge. While this pattern holds for investment inflows to developed countries, for developing countries the surge in investment flows continued in 1991, having fallen somewhat in 1989. Investment inflows to the countries of Central and Eastern Europe have also grown rapidly since the liberalization of their investment regimes in the late 1980s, although the rate of growth slowed down in 1991, as discussed in E/C.10/1993/2.

3. These observations raise the question of the extent to which the substantial increase in global foreign-direct-investment flows during 1986-1990 was in response to the rapid growth of the world economy following the recession of the early 1980s or whether additional circumstances played a role in explaining that increase and, if so, whether these circumstances are likely to continue to exercise an influence in the future. A number of factors - broadly categorized into cyclical, policy-related and structural - help to explain the increase and subsequent fall in investment flows in the 1980s as well as their likely future performance.

(a) Cyclical factors. As in domestic companies, fluctuations in economic activity in home and host countries associated with business cycles are an important factor influencing the investment decisions of transnational corporations. On the other hand, the long-term strategic objectives of transnational corporations concerning various economies - for example, to preserve or expand market share abroad or to penetrate new markets - also exert an influence on their investment decisions. Thus, transnational corporations may discount the impact of low growth to the extent that they wish to accomplish a specific set of objectives in line with their overall long-term strategy. For example, the fall in domestic output of Central and Eastern

European countries has not inhibited transnational corporations from establishing a presence in those potentially lucrative markets. 1/ Nevertheless, a slow-down in economic growth, even if perceived as a temporary and short-term phenomenon, is likely to constrain planned investments by transnational corporations and lead them to either postpone their investment outlays or, if slow growth persists, to revise their plans downwards;

(b) Policy-related factors. Transnational corporations may respond to policy changes that have an impact on their overall strategy, and their response may continue even after the initial policy adjustment has taken place. Significant policy changes that occurred during the second half of the 1980s related to the liberalization of trade regimes; the Plaza Accord in September 1985, in which the devaluation of the dollar in relation to the yen contributed to a wave of outward investment by transnational corporations from Japan; the liberalization of foreign-direct-investment regimes and the introduction of legislation in many countries that allows participation of transnational corporations in the privatization of state enterprises; and protectionist policies in the form of non-tariff barriers became more pronounced in some key markets and industries leading to defensive investments. Other significant policy changes that were introduced for the first time during the second half of the 1980s related to regional integration and included the completion of the European Community Single Market by 1993 and the conclusion of the Free Trade Agreement between the United States and Canada (with prospects of expanding it into a North American Free Trade Area);

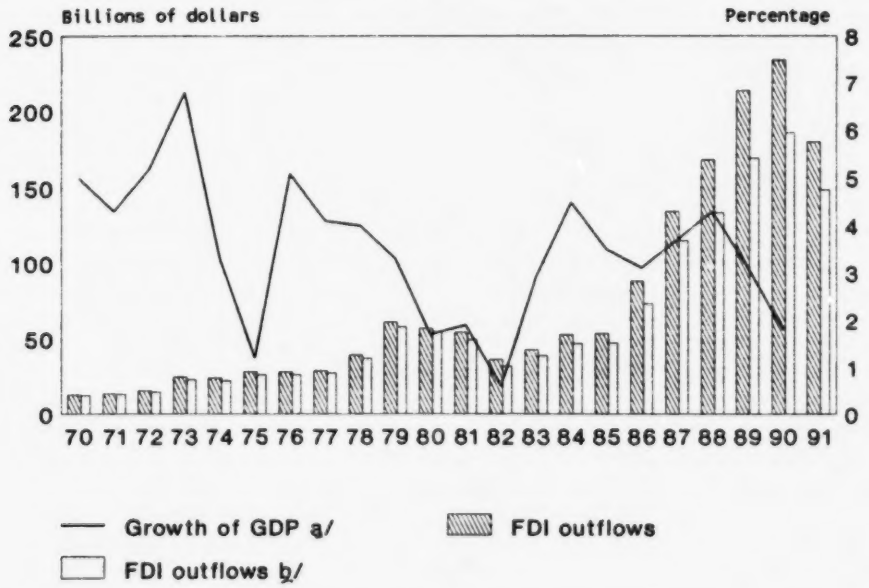
(c) Structural factors. These factors relate to changes in the structure of the world economy, some of which were brought about by the past activities of transnational corporations and their impact on the growth of foreign direct investment. The existence of a sizeable stock of foreign direct investment and the need to maintain its productive capacity, as well as the magnitude, increasing complexity and integration of international production, facilitated by technological developments, are factors that are likely to stimulate the future growth of investment flows and could influence their rate of growth. Moreover, shortages of skilled and unskilled labour and the high cost of labour in some developed countries and in the newly industrializing economies are factors that gave - and continue to give - an extra push to transnational corporations to invest abroad. Finally, sectoral and country imbalances in the extent of transnationalization, though not of a structural nature, raise the question of whether investment flows will continue to increase in order to alleviate these imbalances.

The growth in foreign direct investment during the second half of the 1980s is characterized by the interplay of cyclical, policy-related and structural factors. They are reviewed below in turn.

I. CYCLICAL FACTORS

4. There appears to be a pro-cyclical relationship between investment flows and the growth of world-wide output (fig. 1). The decision by transnational corporations to invest abroad is affected by the growth and economic conditions both at home and abroad. There is usually a great deal of overlap between growth conditions in the home country and abroad, since the increasing interdependence of the world economy implies that cyclical fluctuations in, typically, large developed economies will be transmitted to other countries. Cyclical fluctuations in economic activity at home impact the level and growth rate of investment outflows by influencing investment plans of parent companies, as well as their ability to raise the necessary capital to finance these investments. Similarly, fluctuations in growth rates abroad are also likely to affect the level and growth of investment inflows by influencing expectations of foreign investors regarding potential future earning.

Figure I. Foreign-direct-investment outflows and rate of growth of real gross domestic product, 1970-1991



Source: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on International Monetary Fund, balance-of-payments tape, retrieved in October 1992; OECD estimates; World Investment Directory, Global Trends (United Nations publication, forthcoming); and United Nations Secretariat, Department of Economic and Social Development, Development Policy and Analysis Division, data bank of world development statistics.

a/ 1980 prices.

b/ Excluding Japan.

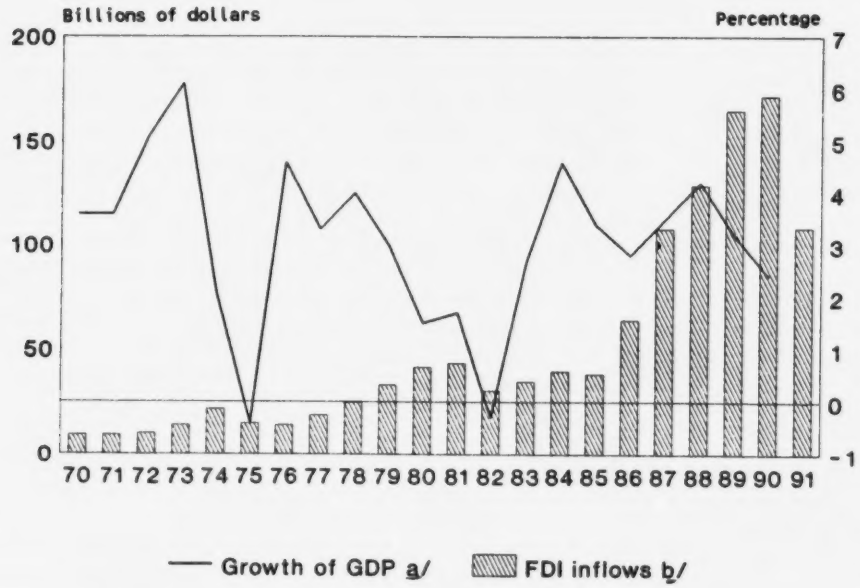
A. The perspectives of home and host countries

5. A close correlation has been observed between foreign-direct-investment outflows and the growth of domestic output of major home countries over time. 2/ Falling or slowly growing domestic demand in home countries is likely to reduce the profits of parent companies and lead them to scale down operations or postpone the undertaking of new investments both at home and abroad. A period of recession in the home country, especially if prolonged, can lead transnational corporations to revise their investment plans downwards (at least temporarily), even when their long-term strategies suggest the opposite. On the other hand, comparatively high growth rates in host countries can give transnational corporations an impetus to invest abroad, even when faced with deteriorating conditions at home. Growing host-country markets may be considered particularly attractive by transnational corporations located in countries experiencing a cyclical downturn and may induce them to invest abroad in spite of unfavourable growth conditions in their home countries. Nevertheless, the global nature of economic recessions or booms suggests that, at least among developed countries, differentials in growth rates between home and host countries are not likely to play a major role in the investment decisions of transnational corporations.

6. There appears to be a close relationship between foreign-direct-investment inflows to developed countries and changes in their rates of domestic economic growth (fig. II). Investment inflows in developed countries appear to have exhibited a pro-cyclical path in response to the growth of domestic output in these countries, with peaks in domestic economic growth followed by peaks in investment flows. The pro-cyclical nature of the relationship between investment flows and domestic growth in developed countries, coupled with the fact that most foreign direct investment is concentrated in developed countries (intra-"triad" foreign direct investment - between the European Community, the United States and Japan - accounted for 70 per cent of world-wide inflows and 83 per cent of world-wide outflows in 1990) explains, to a certain extent, the 1991 fall in investment flows, as discussed in E/C.10/1993/2.

7. Flows of investment to developing countries, which also appear to follow a pro-cyclical path, dipped in 1989 but continued to increase thereafter (fig. III). During the 1986-1990 global investment boom, inflows in developing countries surged a year later than inflows to developed countries, and continued to grow unabated in 1991 in spite of the fall in world-wide inflows. In 1990, growth rates in these countries were significantly higher than in developed countries, suggesting that differential growth rates may, indeed, play a role in influencing the investment decisions of transnational corporations located in countries experiencing stagnant growth.

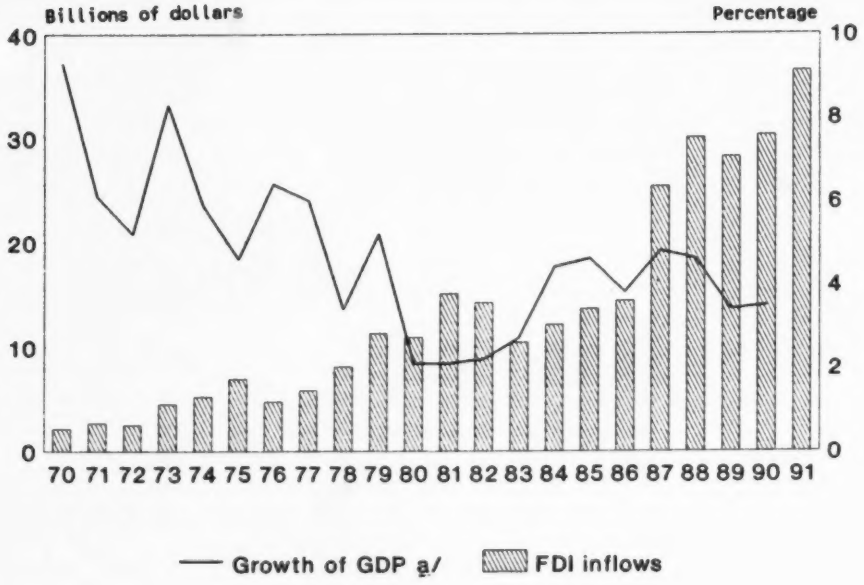
Figure II. Foreign-direct-investment inflows to developed countries and rate of growth of real gross domestic product, 1970-1991



Source: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on International Monetary Fund, balance-of-payments tape, retrieved in October 1992; OECD estimates; World Investment Directory, Global Trends (United Nations publication, forthcoming); and United Nations Secretariat, Department of Economic and Social Development, Development Policy and Analysis Division, data bank of world development statistics.

a/ 1980 prices.

Figure III. Foreign-direct-investment inflows to developing countries and rate of growth of real gross domestic product, 1970-1991



Source: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on International Monetary Fund, balance-of-payments tape, retrieved in October 1992; OECD estimates; World Investment Directory, Global Trends (United Nations publication, forthcoming); and United Nations Secretariat, Department of Economic and Social Development, Development Policy and Analysis Division, data bank of world development statistics.

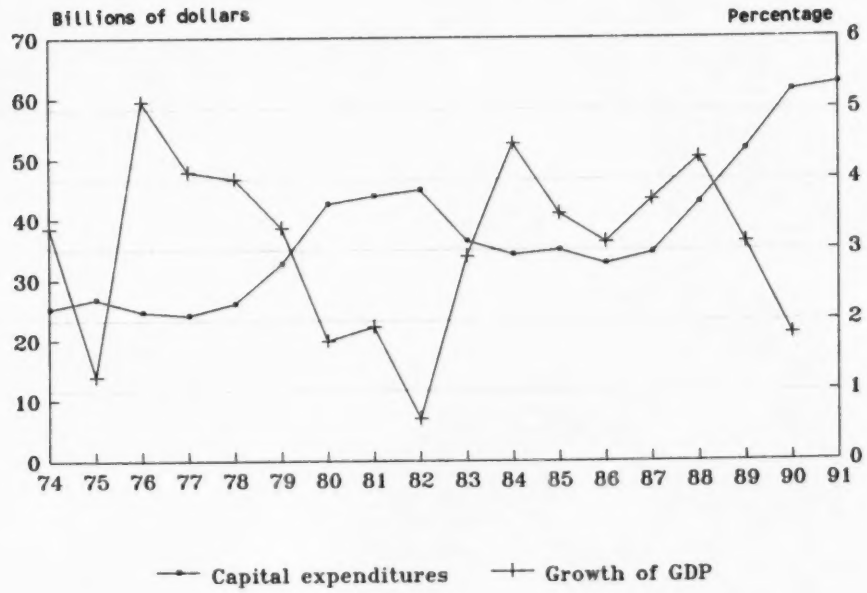
a/ 1980 prices.

8. Capital expenditures of majority-owned foreign affiliates of United States transnational corporations, which indicate the investment plans of companies already located abroad, reflect both home and host-country conditions, and it is not possible to differentiate between the two. Sluggish growth in domestic demand in the home country may reduce profits and constrain the ability of parent companies to finance the capital expenditures of their affiliates by reducing the availability of funds for intra-company loans. At the same time, high growth rates and favourable growth prospects in the host countries in which the affiliates are located can have a positive effect on planned capital expenditures which, at least in part, could mitigate the adverse impact of the financial constraints facing parent companies.

9. Similarly to private domestic investment in the United States, actual capital expenditures of majority-owned foreign affiliates of United States transnational corporations have followed a pro-cyclical path (fig. IV). 3/ The impact of a recession or slow growth in the world economy is reflected in the capital expenditures of majority-owned foreign affiliates of United States transnational corporations through a downward revision of planned capital expenditures and through a more rapid reaction of planned expenditures to changes in the rate of economic growth in comparison to actual expenditures (table 1). Indeed, periods of recession or slow growth, such as the early 1980s, have led to a downward revision of capital spending by foreign affiliates. Similarly, sluggish growth in the United States during 1991 and 1992 has resulted in a downward revision of planned capital expenditures by majority-owned foreign affiliates of United States transnational corporations between the middle and end of 1991. 4/ Japanese transnational corporations have also revised their spending plans downwards, partly owing to a decline in profits of parent companies in Japan due to deteriorating domestic economic conditions. 5/ In particular, these conditions may have a substantial impact on investments by small and medium-size transnational corporations, which are probably more exposed to home-country market conditions owing to their low degree of transnationalization and are thus more susceptible to fluctuations in domestic demand. In the case of United States majority-owned affiliates abroad, planned capital spending has reacted more rapidly to changes in growth rates than actual spending. For example, actual expenditures fell in 1983 in response to slow economic growth and continued to decline in 1984 even after the world economy began to grow again, while for planned expenditures the trend was reversed.

10. Investment flows appear to respond to fluctuations in the rates of growth after a lag of about two years, although the year-to-year volatility of these flows make that pattern less apparent. A similar lag is observed in the response of capital expenditures of majority-owned affiliates of United States transnational corporations to cyclical fluctuations in growth. For example, the recession of 1980-1982 led to a considerable fall in the growth rate of planned capital expenditures of foreign affiliates in the year following the end of the recession. Therefore, investment flows, as well as planned and actual capital expenditures, appear to follow closely swings in economic activity after a time lag.

Figure IV. Actual capital expenditures by majority-owned non-bank foreign affiliates of United States transnational corporations and growth rate of real gross domestic product, a/ 1974-1991



Source: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on United States, Department of Commerce, Survey of Current Business, various issues; United Nations Secretariat, Department of Economic and Social Development, Development Policy and Analysis Division, data bank of world development statistics.

a/ 1980 prices.

Table 1. Planned and actual capital expenditures by majority-owned non-bank foreign affiliates of United States transnational corporations

(Percentage change over previous year)

	World		Developed countries		Developing countries	
Year	Planned	Actual	Planned	Actual	Planned	Actual
1974	22	23	21	26	38	28
1975	3	6	1	5	18	18
1976	-5	-8	-3	-5	-12	-19
1977	12	11	15	15	11	9
1978	15	12	14	14	25	13
1979	22	25	20	25	28	20
1980	24	30	24	29	22	38
1981	7	3	1	-2	28	23
1982	6	1	4	-2	12	11
1983	-4	-18	-1	-16	-6	-20
1984	12	-6	14	-3	10	-13
1985	15	2	15	5	15	-4
1986	2	-7	5	-2	-6	-18
1987	3	5	4	9	1	-8
1988	23	24	21	24	29	18
1989	15	13	11	11	31	18
1990	17	19	16	18	27	22
1991	3	..	1	..	10	..
1992	4	..	3	..	10	..

Source: United States, Department of Commerce, Survey of Current Business, various issues.

11. During the 1980s, the rates of growth of GDP (at 1988 prices) of developed and developing countries as a whole were not substantially different. As a result, foreign-direct-investment inflows fluctuated in the same direction in both developed and developing countries. However, given that developing countries as a whole grew faster than developed countries in 1990 and 1991, coupled with better prospects for future growth, investment flows to the former (and their share of total flows) would be expected to increase. 6/ Indeed, in 1991, the share of developing countries in total inflows rose to 25 per cent from an average of 17 per cent during 1985-1990. In other words, transnational corporations continued to invest in developing countries, partly in response to the more favourable growth prospects; in fact, investments in developing countries tend to be highly concentrated in the rapidly growing newly industrializing economies of Asia and in a few countries in Latin America.

12. Between 1990 and 1992, the percentage increase of planned capital expenditures of majority-owned foreign affiliates of United States transnational corporations in developing countries were considerably above those for developed countries (table 1). Again, stagnating growth rates in the latter compared with the former, coupled with improved business prospects in

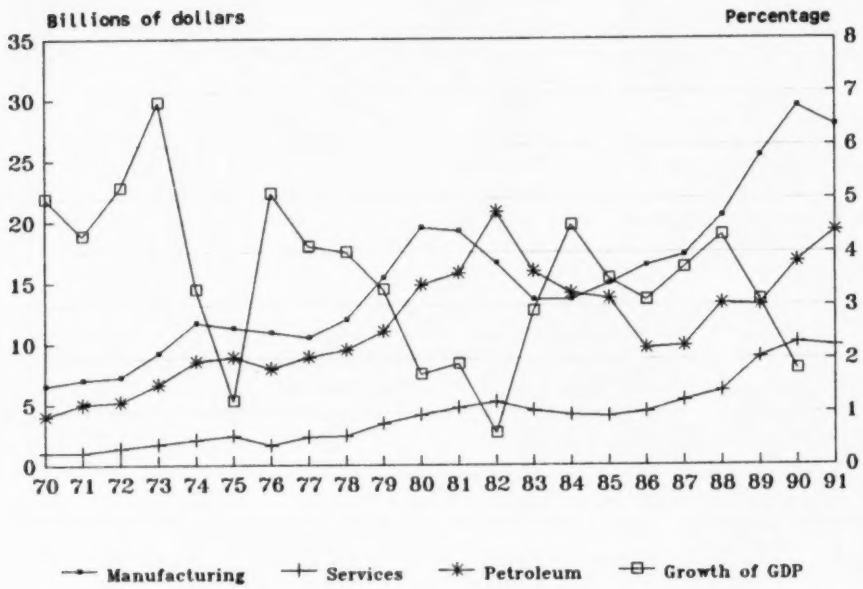
Latin America and Asia may explain, at least in part, the difference in the increase of these expenditures between developed and developing countries. In contrast, during the second half of the 1980s, the growth rate of planned (and actual) capital expenditures of these affiliates in developed countries exceeded those in developing countries. Growth prospects for developed countries appeared to be favourable (given, for example, improved growth prospects for the European Community in view of the impending single market by 1993), which probably led to an acceleration of the rate of growth of capital expenditures of these affiliates in developed countries.

13. These observations allow us to draw some conclusions regarding the role played of cyclical fluctuations in economic growth in influencing the post-1985 boom in investment flows and subsequent fall in 1991. The growth of the world economy appears to have stimulated investment flows during the second half of the 1980s and, correspondingly, the fall in those flows in 1991 may be partly attributed to deteriorating growth conditions in the world economy. These conditions were confined mostly to developed countries which are, however, the principal sources of foreign direct investment. Developing countries as a whole have seen their share in total inflows rise to levels attained during the first half of the 1980s, partly in response to their comparatively stronger economic performance. Differences in growth performance and prospects between developed and developing countries could, therefore, influence the distribution of foreign direct investment between these two groups, since the growth rate of host countries influences both investment inflows and capital expenditure plans of affiliates already located there.

B. Sectoral differences

14. The outward stock of foreign direct investment of major home countries in services grew faster between 1975 and 1990 than that in the primary and secondary sectors. 7/ This raises the question of whether cyclical fluctuations have a different impact on the growth of investment flows in services from the growth of these investments in the manufacturing and primary sectors. Capital expenditures of majority-owned foreign affiliates of United States transnational corporations in manufacturing, services and petroleum have followed a broadly similar upward path with fluctuations in response to cyclical movements (fig. V). In comparison to manufacturing and petroleum, however, capital spending in the services sector appears to be less volatile; in other words, in spite of a pro-cyclical trend, the size of oscillations of expenditures in that sector is smaller than in the other two. One possible explanation is that transnational services corporations, which are less transnationalized than manufacturing companies, are likely to expand investments abroad even during periods of slow growth in order to attain a particular level of outward investment. In addition, it may well be that, given the non-tradable nature of most services, the supply of foreign markets cannot be switched, if need be, to exports (as in the case of manufacturing); hence market positions abroad need to be maintained through continuing investments. Cyclical fluctuations are therefore less likely to have an impact on services investment to the same extent that they do on manufacturing investments. The increase in the share of services in the stock of outward investment by the major home countries could therefore suggest that investment flows may become less affected by cyclical fluctuations in the rates of growth.

Figure V. Actual capital expenditures by majority-owned non-bank foreign affiliates of United States transnational corporations, by sector, and growth rate of real gross domestic product of the world economy, a/ 1970-1991



Source: United States, Department of Commerce, Survey of Current Business, various issues.

a/ 1980 prices.

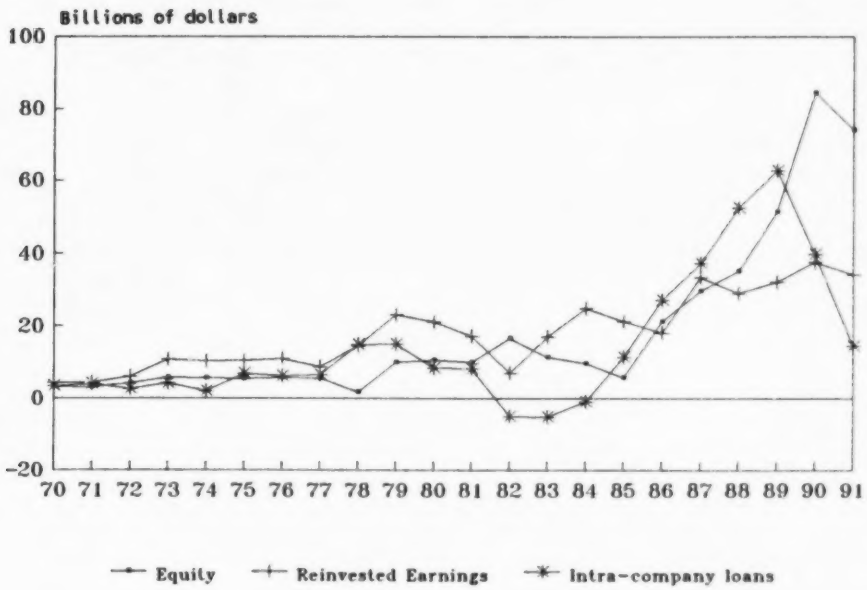
C. Impact on the mode of financing investment

15. Fluctuations in domestic growth are likely to affect the mode of financing foreign direct investment - that is, the share of equity, reinvested earnings and intra-company loans in total foreign-direct-investment outflows. 8/ Transnational corporations may be inclined to use different means of financing investments abroad during periods of recession, as opposed to periods of robust growth; for example, a profit decline of the parent company or the high cost of capital in the home country may induce firms to use profits earned in the host country for investment purposes. On the other hand, the same conditions could lead to higher profit repatriation in order to alleviate the profit decline experienced by parent companies, thus reducing funds available for reinvestment. Not only is the preferred mode of financing investment on the part of transnational corporations likely to be affected by cyclical fluctuations, but also some forms of investment may be more susceptible to the impact of these fluctuations than others. As a result, the overall magnitude and direction of the impact of business cycles on each of the components of foreign direct investment are likely to affect total investment flows.

16. Investment flows from the five largest home countries (France, Germany, Japan, United Kingdom and the United States) grew rapidly during the second half of the 1980s. Nevertheless, the components of these outflows - equity, reinvested earnings and intra-company loans - did not all grow at the same rate. The divergence between their respective growth rates became more apparent after 1977 and especially during the 1980s: during the second half of that period, equity investments and intra-company loans grew faster than reinvested earnings (fig. VI).

17. Differences in oscillations of the components of investment flows would seem to suggest that business cycles may have a different impact on the mode of financing investments abroad. 9/ For example, during periods of slow growth in the world economy, earnings of affiliates may decline and, assuming that profit remittances remain the same, less profit will be available for reinvestment. Under such conditions, equity investments may also decrease reflecting business pessimism of transnational corporations. Intra-company loans, on the other hand, may increase since affiliates may rely on funds obtained from the parent company to increase investments in view of declining profits.

Figure VI. Foreign-direct-investment outflows from France, Germany, Japan a/, United Kingdom b/ and United States, 1970-1991



Source: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on International Monetary Fund, balance-of-payments tape, retrieved in October 1992.

a/ Does not include reinvested earnings.

b/ Does not include equity.

18. During the 1980s, reinvested earnings accounted for about one half of total investment outflows from developed countries (E/C.10/1993/2). Given the importance of reinvested earnings as a means of financing outward investments, factors that influence the decision of affiliates to reinvest or repatriate profits are likely to explain a large portion of the fluctuations in investment outflows. Cyclical fluctuations in home and host countries are one factor that could influence the decisions of affiliates to reinvest or repatriate profits. During downturns in economic activity in home countries, foreign affiliates may have to rely on their own earnings for foreign direct investment. On the other hand, foreign affiliates may be required to repatriate profits in order to alleviate the decline of profits experienced by parent companies. Indeed, evidence from the largest home countries appears to support the latter hypothesis: the ratio of reinvested earnings to total investment outflows decreased during periods of low growth; the reverse was true during periods of high growth (fig. VII).

19. Other factors, however, can affect the extent to which earnings are repatriated or reinvested independently of the impact of cyclical fluctuations on economic growth. The cost of capital of alternative means of raising funds and prevailing exchange rates may be considered among those factors that, although not necessarily of a cyclical nature, can influence the extent to which foreign direct investment is financed out of reinvested earnings of foreign affiliates. 10/ A high cost of capital in host countries, for example, may induce affiliates to reinvest their earnings rather than borrow from host-country equity markets. On the other hand, a depreciation of exchange rates of host countries may discourage affiliates from repatriating profits (which would reduce the value of profits when translated into the currency of the home country). It may, therefore, be difficult to attribute a change in the share of total investment flows accounted for by reinvested earnings to cyclical fluctuations alone.

20. Cyclical fluctuation in economic activity in home countries affects operating profits (total revenues less total operating costs) of parent companies, which could in turn affect the mode of financing investment abroad. Foreign affiliates often rely on loans obtained from parent companies to expand operations. Assuming that parent firms face adverse domestic conditions, which reduce their operating profits and force them to adjust their investment plans at home and abroad, it might be expected that intra-company loans from parent companies to their affiliates would decline. In other words, low operating profits and cash-flow problems facing parent companies in home countries would imply that foreign affiliates might have to find alternative means to finance an expansion of their operations. Affiliates, for example, might have to raise funds from international markets or from equity markets of their host countries instead of relying on loans obtained from their parent companies. As a result, the share of intra-company loans in total investment outflows would be expected to decline during a cyclical downswing (possibly with a time lag).

Figure VII. Ratio of reinvested earnings and of intra-company loans to foreign-direct-investment outflows for Germany, United Kingdom and United States, 1970-1991

Source: United Nations Secretariat, Department of Economic and Social Development, Transnational Corporations and Management Division, based on International Monetary Fund, balance-of-payments tape, retrieved in October 1992.

21. Such a pattern does seem to emerge for the three of largest outward investors (Germany, United Kingdom and United States) during 1989-1991. Although the ratio of intra-company loans to total investment flows declined substantially during that period, the same pattern was not observed during earlier periods of slow growth (fig. VII). This might suggest that home-country cyclical growth factors played an important role in the 1991 fall in investment flows in comparison to previous periods of slow growth. Specifically for the United States, the sharp drop in operating earnings of United States transnational corporations during 1990 and 1991 considerably limited their ability to provide new loans to their affiliates abroad. 11/ In fact, the repayment of loans on the part of affiliates has exceeded new loans to these affiliates and has led to a decline in the share of total outflows from the United States accounted for by intra-company loans during that period.

D. Mergers and acquisitions

22. The principal objectives of the companies involved in the international mergers-and-acquisitions boom of the 1980s (which came to an end in the last years of the 1980s), were to consolidate their position within a given industry and to establish themselves in foreign markets. Companies became increasingly aware of the necessity to globalize operations in order to expand market share and achieve economies of scale and scope. The restructuring of operations through mergers and acquisitions along the lines of a larger geographical area as, for example, in the case of the European Community, became important in light of policy developments and strategies of transnational corporations. Acquisitions were perceived as a less expensive means of gaining a foothold in the market of a host country in comparison to establishing new productive facilities; indeed, the majority of foreign direct investment in the United States and Western European countries was in the form of acquisitions as opposed to greenfield investments. The underlying reasons for the boom in mergers and acquisitions during the 1980s, therefore, rest primarily with the strategies pursued by transnational corporations, dictated by competitive forces and technological changes, as well as by policies adopted by Governments of host countries. 12/

23. The end of the mergers-and-acquisitions boom coincided with the end of the strong growth of the world economy. It is, however, difficult to separate the cyclical impact on the slow-down of mergers and acquisitions from that of other factors, such as higher interest rates and stock-market valuations. Nevertheless, it appears that slow economic growth did play a role in influencing the slow-down of mergers and acquisitions by making it more difficult for companies that had been acquired to be profitable in the face of adverse domestic conditions. Several companies created from mergers have reported lower earnings than expected owing to sluggish domestic demand in developed economies. At the same time, transnational corporations from countries facing deteriorating economic conditions and declining profits at home are less likely to engage in international takeovers. As a result, the slow-down of the growth of the world economy appears to have played a role in the decline of mergers and acquisitions.

E. Conclusions

24. There are several implications that arise from the above discussion of cyclical factors and their role in the growth and subsequent fall in investment flows. The growth performance of the five largest home countries, where most investment flows originate, affects the growth of world-wide investment flows. The interdependence of the world economy implies that cyclical fluctuations in growth will be eventually transmitted to other countries. Nevertheless, the distribution of investment flows between developed and developing countries could be influenced by differentials in growth rates, as the experience of the 1990s seems to suggest. Recipient countries may be somewhat shielded from ebbs in investment flows if domestic economic conditions are conducive to profitable investments and long-term growth prospects are favourable. Even when there is an economic downturn in the major home countries, affiliates already located abroad may still continue to invest through profits accruing from operations in the host countries. Affiliates with a long history of foreign direct investment in a given host country are likely to be more profitable than newly established affiliates and, hence, in a better position to shield the host country from cyclical downturns by relying on domestically earned profits. The ability of foreign affiliates to raise funds locally is important in alleviating shortages of funds at times of recession in principal home countries. Measures to allow the participation of affiliates in host-country equity markets would therefore decrease their reliance on parent companies for raising finance. At the same time, decreasing reliance on a single home country for investment will diminish the likelihood of a decline in inflows if that country enters a period of recession.

II. POLICY CHANGES

25. While cyclical factors may explain previous changes in foreign-direct-investment flows, the surge that occurred during 1986-1990 cannot be solely attributed to them. Clearly, other factors, including factors relating to changes in existing policies, also played a role. Although those factors may reflect one-time policy changes that took place during that period, their implications still continue to be felt.

A. Trade liberalization

26. Foreign direct investment is closely interlinked with international trade: for the largest home countries, transnational corporations account for most exports and imports (80 per cent for the United States in 1989), while intra-firm trade accounts for between one fourth and one third of total international trade. Measures to liberalize trade apply especially to manufacturing and, on a limited basis, to services.

27. Trade liberalization accelerated in the 1980s, especially in developing countries. Trade-liberalization measures exert an influence on the growth of foreign direct investment by allowing transnational corporations to establish facilities in countries where production costs are low and export their output; by enabling the formation of regional core networks centred around a member of

the "triad"; and by allowing the integration of production regionally or globally.

28. Within the framework of the general agreement on trade in services - if and when adopted - the overall trend towards trade liberalization could be extended to services. The general agreement on trade in services would also affect immediately cross-border trade and the framework for foreign direct investment in services, as it has a strong liberalizing thrust. That would greatly facilitate and even make possible foreign direct investment in a number of service industries, such as telecommunication and air transportation. 13/

B. Exchange-rate movements

29. From the viewpoint of transnational corporations, the cost of acquiring assets in different countries depends on the prevailing exchange rates. The impact of exchange-rate fluctuations on investment flows is indirect. Typically, a depreciation of the currency of the host country (in relation to the currency of the home country) encourages the inflow of foreign direct investment by reducing investment costs in terms of the home country currency, while an appreciation of the domestic currency encourages the outflow of foreign direct investment. The experience of the United States and Japan offer two examples: a depreciation of the dollar vis-à-vis the yen during the second half of the 1980s made United States assets less expensive to Japanese firms, and the perceived increase in the corporate wealth of Japanese firms encouraged investment flows to the United States. 14/

30. Thus, the 1985 Plaza Accord, leading to a considerable appreciation of the Japanese yen vis-à-vis the dollar, may be viewed as a policy change that had a considerable impact on investment outflows from Japan. 15/ The large appreciation of the yen (in conjunction with the underlying structural factors of rising production costs coupled with a shortage of skilled labour at home) raised the prices of Japanese exports to a point where the fall in price competitiveness would have made it difficult to retain market share. In addition, the appreciation of the yen against the dollar made the acquisition of United States companies relatively inexpensive. This encouraged a wave of outward investments by Japanese transnational corporations in manufacturing and in services, especially in the United States. While strategic considerations (such as the need to secure market access in the European Community and the United States) also played an important role in the decision of these firms to invest abroad, the appreciation of the yen was a contributing factor.

C. Liberalization of foreign-direct-investment policies and privatization

31. The trend towards the liberalization of foreign direct investment policies, which accelerated during the second half of the 1980s, especially in the services sector, created an entirely new enabling framework for transnational corporations. In 1991, for example, almost all changes in the investment regimes of some 30 countries were in the direction of greater liberalization. At present, not only do all countries allow foreign direct investment, but they often compete with each other for attracting such

investments. The liberalization of regulations on foreign direct investment in the services sector is particularly noteworthy, as manifested by the dramatic growth of investment flows in services.

32. The liberalization of the external transactions has been accompanied by privatization programmes internally. In 1990, more than 70 countries had active privatization schemes, and the value of state enterprises sold reached over $185 billion. 16/ Despite the lack of systematic evidence as to the extent of involvement of transnational corporations in the process of privatization, it is important in Latin America and in Central and Eastern Europe. The involvement of transnational corporations in privatization schemes has played a modest role in explaining the surge in investment flows during the second half of the 1980s, since most of these schemes were introduced only towards the end of that period.

D. Non-tariff barriers

33. In spite of the overall trend towards trade liberalization, non-tariff barriers in the form of voluntary export restraints have been used by some countries in order to limit the flow of imports in selected industries. For example, exercising voluntary export restraints, Japan was compelled to reduce exports of automobiles and semiconductors to the United States. Such policies have led to fears regarding the future imposition of non-tariff barriers in other industries and to the growing necessity to preserve market access through foreign direct investment. Non-tariff barriers, coupled with threats of the imposition of trade restrictions, whether perceived or actual, encouraged Japanese automobile manufacturers to establish production facilities in host-country markets, especially in the United States, in order to secure access to these markets. Nevertheless, given that most Japanese investments in the United States were in the services sector, this factor has, most likely, played a limited role in explaining the rapid growth of investment flows during the second half of the 1980s.

E. Regional integration

34. Regional integration schemes (the completion of the formation of a single market among members of the European Community by 1993 and the Free Trade Agreement between the United States and Canada) sparked significant investment flows to and within the regions involved. The desire by transnational corporations from third countries to become regional "insiders", either through greenfield investments or mergers and acquisitions, led to a faster growth of foreign direct investment in the European Community than would have otherwise been expected. 17/ At the same time, transnational corporations already located within the European Community began to reorganize and rationalize their investments, taking a Community-wide approach, which led to a substantial rise in intra-regional investment flows and in cross-border mergers and acquisitions. A similar process of reorganization of investments took place by transnational corporations from the United States in response to the Free Trade Agreement between the United States and Canada. Investment flows from outsiders as a result of the Free Trade Agreement also increased, with

transnational corporations increasingly viewing North America as a single integrated market. 18/

35. Given that these were one-time policy changes, it may be expected that the growth of investment flows to the European Community and North America (including intra-regional investment flows) would eventually slow down. Indeed, that seems to have happened in 1991 in the case of the European Community, at least as regards investments from Japan. Such a view, however, would ignore the stimulus to economic growth from the dynamic effects arising from the formation of the single market. The expansion of markets and growth of demand - the dynamic effects arising from that regional integration scheme - are likely to present new investment opportunities and encourage new inflows of foreign direct investment, even after the completion of the single market at the end of 1992.

G. Conclusions

36. It seems that one-time policy changes have given an extra push to the cyclical factors that played a role in the growth of investment flows in the 1980s. While some of the impacts of these policies on investment flows may appear to have weakened (for example, gaining a foothold inside the European Community), other impacts are still in operation or have just begun (for example, the implications for foreign direct investment through the dynamic effect of regional integration on growth). Moreover, the introduction of new policies liberalizing trade and investment flows and allowing the involvement of transnational corporations in the process of privatization will continue to affect the growth of investment flows positively.

III. STRUCTURAL FACTORS

37. The changing structure of the world economy, with a sizeable and growing foreign-direct-investment stock in place and the emergence of an integrated international production system, also played a role in explaining the size of the surge in investment flows during the second half of the 1980s. These structural changes in the world economy suggest that, in the absence of cyclical and policy-related factors, the upward trend followed by investment flows is likely to continue in the future.

A. Growth of the stock of foreign direct investment

38. The stock of global foreign direct investment has increased steadily in the period since the Second World War and, in 1991, was estimated to have reached about $1.9 trillion in book value. 19/ World-wide outward investment stocks (valued in current dollars) grew by an annual average of 15 per cent during 1985-1991, compared with 10 per cent during 1980-1985. 20/ Associated with that stock, world-wide sales of foreign affiliates doubled between 1985 and 1990 (table 2). Stock data best capture the extent of the activities of transnational corporations, since they represent the capacity to generate streams of future output. The fact that a sizeable stock of foreign direct investment is already in place suggests that its capacity to generate

earnings will continue to grow in the future. The magnitude of reinvested earnings, a significant component of investment flows, may continue to increase, which would give rise to higher future investment flows. Moreover, the sizeable investment stock already in place is likely to drive investment and associated resource flows into self-sustained growth, thus fostering the capacity of that stock to generate earnings in the future.

Table 2. World stock of foreign direct investment and sales of foreign affiliates, 1960-1991

(Billions of dollars)

Year	Outward stock	Sales abroad
1960	68	
1967	112	
1973	211	
1980	517	
1981	856	
1982	910	2 400
1983	947	2 300
1984	989	2 500
1985	1 042	2 500
1986	1 096	2 900
1987	1 184	3 500
1988	1 319	4 200
1989	1 487	4 400
1990	1 700	5 500
1991	1 880	..

Source: "Trends in foreign direct investment" (E/C.10/1993/2); World Investment Directory: Global Trends (United Nations publication, forthcoming).

B. Emergence of an integrated international production system

39. The sizeable stock of foreign direct investment attributable to over 35,000 transnational corporations and the world-wide sales of about $5.5 trillion associated with that stock in 1990 suggest that international production has become an important structural characteristic of the world economy. Partly, this is the result of technological developments in the area of communications, which have enabled a greater coordination of activities between parent transnational corporations and their affiliates or among affiliates and have allowed firms to achieve a higher degree of integration of these activities. In addition, falling transportation and communications costs have meant that transnational corporations, even small and medium-size firms, are now able to coordinate activities world wide and export intermediate or final goods to other countries or from foreign affiliates to home countries. These technological developments have brought about changes in the organizational structure of transnational corporations, driven by heightened

competition and a growing awareness among companies of the necessity to invest abroad in order to place themselves in a position to serve domestic markets better. These developments are leading to the emergence of an integrated international production system in which linkages of affiliates with parent companies or with other affiliates are multiplying and/or are becoming more complex.

40. The continuous move to organize international production in a regionally or globally integrated manner as dictated by strategies of transnational corporations (E/C.10/1993/4) implies that a growing share of resources of a country, including capital, are involved in the building of such an integrated production system. The growing integration of international production implies that the magnitude of cross-border intra-firm flows of goods, services, technology and investment capital is rising and is likely to continue to do so in the future. Within the framework of the emerging integrated production system, the nature of cross-border transactions is changing, with many (especially intangible) activities not reflected in investment flows as measured conventionally. Furthermore, transnational corporations have established a multitude of non-equity links, including strategic alliances, which, again, are not captured by foreign-direct-investment data. In other words, the emergence of an international integrated production system is creating a certain self-sustaining momentum which has important implications for the growth of investment flows as well as for the growth of non-equity intra- and interfirm cross-border transactions.

IV. FUTURE PROSPECTS

41. In general, of course, firms that possess tangible or intangible assets arising from ownership will continue to maximize net benefits by internalizing transaction costs and by investing in countries that provide advantages particular to their location. 21/ The combination of ownership, internalization and location-specific advantages will, therefore, continue to induce firms to engage in international production and to locate value-adding activities abroad. However, the rise in investment flows during the second half of the 1980s and the fall in these flows in 1991 raise the question of whether these flows will continue to increase in the future from a higher level (investment flows in 1991, despite their fall, are still above the level reached in 1988). Assuming that this is indeed the case, a related question is whether that increase will take place at an increasing or decreasing rate of growth. Although cyclical factors will continue to influence the growth of investment flows, the continuation of policy changes and the changing structure of the world economy resulting from the activities of transnational corporations make it probable that investment flows will not fall to the level of the early 1980s but will continue to grow from a higher level. Policy developments, imbalances in the degree of transnationalization of countries and sectors and structural factors that are likely to encourage that increase are discussed below.

A. Future prospects regarding policy developments

1. Liberalization of trade and investment regimes

42. To the extent that trade liberalization continues, transnational corporations - encouraged by technological developments - will have an incentive to invest abroad and reduce production costs by rationalizing their investments. Trade liberalization may also accelerate the organization of international production into regionally or globally integrated networks by allowing the movement of goods and, increasingly, services that is necessary for the formation of an integrated production system.

43. Despite continuous steps towards a greater relaxation of restrictions on foreign direct investment, there is still scope for more extensive liberalization, including on the sectoral level. As regards the services sector (which now accounts for over half of total investment flows from major home countries), it is still possible to further liberalize the regulatory framework for these investments, especially in developing countries. The opening of public utilities, insurance and other services industries to foreign direct investment, coupled with the relatively low tradability of services, is likely to induce services transnational corporations to continue to invest abroad at a high rate. It is also likely that privatization could play a greater role in the future, and some countries (especially in Latin America) are already in the process of replacing debt-to-equity conversion schemes with privatizations as the principal incentive to attract foreign direct investment.

2. Regional integration schemes

44. The continuation of regional integration in Western Europe and North America, as well as the closer integration at the production level in Asia, which is emerging as a result of the activities of transnational corporations in that region even in the absence of a formal institutional framework, are likely to result in further increases in foreign direct investment. Specifically, the extension of the European Community to encompass most members of the European Free Trade Association, leading to the formation of a European economic area, is likely to result in greater intra- and extra-regional investment flows. Similarly, the extension of the United States Canada Free Trade Agreement to include Mexico under the North American Free Trade Agreement has already led to substantial investment flows to Mexico ($4.8 billion in 1991). The envisioned creation of a free trade zone in the western hemisphere (Enterprise for the Americas Initiative) could also have a positive impact on the growth of foreign-direct-investment flows in the future. Again, the desire to be an insider and the impact of dynamic growth effects arising from these regional integration schemes suggest that the attractiveness of these regions to transnational corporations will continue even after the adjustment and reorganization of their investments in response to the one-time changes in geographical and economic boundaries has taken place.

B. Imbalances in degrees of transnationalization

45. Imbalances between the inward and outward investment positions of a country and in the degree of transnationalization between newcomers and more mature foreign investors as well as between services and non-services sectors may suggest that there is room for further transnationalization. Although there is no reason to believe that countries or groups of firms need to converge towards any particular degree of transnationalization, it is possible that international competition will force newcomers to expand their production facilities abroad. At the same time, transnational corporations in services may continue to invest abroad at a rapid rate, and the degree of transnationalization of that sector may, eventually, catch up with that of manufacturing.

1. Country imbalances

46. The imbalance between inward and outward foreign direct investment for Japan as well as the low ratio of inward foreign-direct-investment stock to domestic output (GDP) is not in line with the experience of the other triad members (European Community and the United States). 22/ The alleviation of perceived or actual barriers to inward foreign direct investment is likely to result in increased investments to Japan, leading to greater parity with the other triad members. Concerning outward investment, the position of a country on the development path determines, to a certain extent, the degree of transnationalization of its firms. For example, relatively mature investors, such as the United Kingdom, have a high degree of transnationalization of their firms. Despite the rapid growth of investment flows since 1985, Japan is still a newcomer in comparison to other members of the triad with a long history of outward investments. Although the degree of transnationalization of Japanese firms has risen, as indicated by increases in the ratio of the stock of foreign direct investment to total assets of all companies, Japan remains less transnationalized in comparison to other major home countries (table 3). 23/ It is therefore likely that investment outflows from Japan, despite their recent slow-down, will continue to be substantial in the future.

47. In addition to Japan, other countries in the 1980s have accelerated the pace of transnationalizing their economies. In this regard, the process of transnationalization of the Republic of Korea and Taiwan Province of China, which have become net foreign-direct-investment exporters since 1990 and 1987, respectively, is likely to continue in the future. China itself is rapidly expanding its investment position abroad. Other countries in Asia and Latin America are likely to follow suit. It is conceivable that even some of the countries of Central Europe, once they have completed their transition to market economies, could become sizeable outward investors. Together, these countries could constitute a new and significant source of investment flows in the future.

Table 3. Ratio of foreign-direct-investment outward stock to total assets of the home country, 1990

(Percentage)

Country	
Japan	4.0
United States a/	8.0
Germany	15.4
United Kingdom b/	26.0

Source: World Investment Directory: Developed Countries 1992 (United Nations publication, forthcoming).

a/ 1991. Foreign-direct-investment stock at historical cost adjusted for the finance (except banking), insurance and real estate industry of the Netherlands Antilles.

b/ Ratio of non-bank foreign-direct-investment stock to non-financial assets in 1987.

2. Sectoral imbalances

48. On the sectoral level, the degree of transnationalization varies considerably. Services usually have a lower degree of transnationalization than manufacturing, in spite of the rapid growth of the services sector at home (as share of domestic GDP). For instance, in the case of the United States, some 21 per cent of the assets of transnational services corporations were abroad in 1980, compared to 27 per cent for manufacturing transnational corporations. 24/ To a large extent, this is the case because of restrictions on inward investments in services, the liberalization of which began only relatively recently. Thus, it might be expected that investment flows in the services sector will continue to grow substantially.

C. Shortage of labour

49. Labour shortages and high-cost labour in a number of developed countries and a trend in this direction in several newly industrializing economies have acted as a modest "push" factor, encouraging outward foreign direct investment. Given restrictions in international migration, foreign direct investment may be seen as an alternative means of accessing pools of labour in other countries to alleviate domestic shortages of both skilled and unskilled labour. Indeed, the newly industrializing economies of Asia, facing labour shortages at home, are following the example of Japan and are relocating labour-intensive industries to neighbouring countries where production costs are lower (for example, China and Viet Nam).

* * *

50. Apart from the ownership, internalization and locational advantages that encourage firms to invest abroad, the continuous influence of policy developments in investment, trade and regional integration, imbalances in the degree of transnationalization between countries and sectors and, to a lesser extent, pressures emanating from labour shortages or high-cost labour in some countries suggest that even in the absence of cyclical factors, investment flows will continue to increase. In addition, the stock of foreign direct investment already in place and the greater integration of corporate activities across functions and regions generates a self-perpetuating growth in investment flows.

CONCLUSION

51. The interplay of cyclical, policy-related and structural factors offers a plausible explanation for the growth in investment flows during the second half of the 1980s. The increasing importance of structural factors and the continuing effect of certain policy factors suggest that, on balance, a long-term upward trend in foreign direct investment and international production will characterize the world economy of the 1990s. Nevertheless, foreign-direct-investment flows, like those of domestic investment, will continue to respond to cyclical fluctuations, and these fluctuations may well be transmitted faster world wide as a result of the growing integration of international production. In view of these developments, the transnationalization of the world economy - namely, the share of total value-added performed outside the boundaries of the home country - is likely to increase, strengthening the role of transnational corporations as integrating forces and coordinators of cross-border transactions.

Notes

1/ The growth rate of GDP (at 1988 prices) in Central and Eastern Europe fell dramatically in 1990 and 1991 and was estimated to be -5 and -16 per cent, respectively. For foreign-direct-investment data, see World Investment Directory 1992: Central and Eastern Europe (United Nations publication, Sales No. E.93.II.A.1).

2/ See, for example, DeAnne Julius, Global Companies and Public Policy (London, Pinter Publishers, 1990).

3/ Planned domestic capital expenditures by all United States companies are closely correlated with capital expenditures of majority-owned foreign affiliates of United States parent companies. See Mahnaz Fahim-Nader, "Capital expenditures by majority-owned foreign affiliates of U.S. companies, latest plans for 1992", Survey of Current Business, No. 72 (September 1992), pp. 48-55.

4/ According to a survey taken by the United States, Department of Commerce, Bureau of Economic Analysis in June 1991, majority-owned affiliates of United States transnational corporations planned to increase capital expenditures in 1991 by 10 per cent; in the survey taken in December 1991, that figure was revised to 3 per cent (Mahnaz Fahim-Nader, "Capital expenditures by majority-owned foreign affiliates of U.S. companies, plans for 1992", Survey of

Current Business, No. 72 (March 1992), pp. 43-50). Similarly, planned capital expenditures for 1992 were revised downward in the survey taken in June 1992 in comparison to the survey taken in December 1991 (Mahnaz Fahim-Nader, "Capital expenditures by majority-owned foreign affiliates of U.S. companies, latest plans for 1992", Survey of Current Business, No. 72 (September 1992), pp. 48-55). This is similar to the experience of earlier periods of slow growth: based on a survey taken in December 1981, the growth of planned capital expenditures of these affiliates was 11 per cent; in the survey taken in June 1982, the growth of these expenditures was revised downwards to 6 per cent (Ralph Kozlow, Survey of Current Business, No. 62 (September 1982), p. 43).

5/ Anthony Rowley, "Ebbing streams: Japanese firms curtail their overseas forays", Far Eastern Economic Review, No. 155 (18 June 1992), pp. 78-79.

6/ Based on forecasts of the United Nations Secretariat, Department of Economic and Social Development, growth of GDP at 1988 prices in developing countries will be substantially higher than in developed countries during the early 1990s.

7/ World Investment Report 1992: Transnational Corporations as Engines of Growth (United Nations publication, Sales No. E.92.II.A.19), p. 18.

8/ No systematic information exists on the financing of investments from locally raised capital, which is not included in foreign-direct-investment data reported for the balance of payments.

9/ In addition to growth rates, however, other factors, such as the cost of capital in the host country, may influence the mode of financing investment flows. For example, foreign affiliates may find it more advantageous to raise capital in the host countries if interest rates are low than to borrow from the parent company in order to finance their investments.

10/ Exchange-rate fluctuations also influence the valuation of reinvested earnings and hence total investment flows. The United States, for example, has excluded changes in flows attributed to sizeable exchange-rate fluctuations from the reported foreign-direct-investment data.

11/ Russell B. Scholl, Raymond J. Mataloni, Jr. and Steve D. Bezirganian, "The international investment position of the United States in 1991", Survey of Current Business, No. 72 (June 1992), pp. 46-59.

12/ International Cooperation Agreements and International Mergers and Acquisitions in the 1980s: Central Measures in the Strategies of Transnational Corporations (United Nations publication, forthcoming).

13/ World Investment Report 1992, chap. III.

14/ Kenneth A. Froot and Jeremy C. Stein, "Exchange rates and foreign direct investment: an imperfect capital markets approach", The Quarterly Journal of Economics, No. 106 (November 1991), pp. 1,191-1,217; Paul Krugman and Edward Graham, "The surge in foreign direct investment in the late 1980s: conceptual issues", paper presented at the National Bureau of Economic Research conference "Foreign Direct Investment Today", Boston, 15-16 May 1992.

15/ In 1985, the average exchange rate was 239 yen per dollar; in 1986, the yen appreciated to 169 yen to the dollar and continued to appreciate until 1988, when it reached the point of 128 yen per dollar.

16/ World Investment Report 1992 ..., p. 86.

17/ For a discussion of the impact of the completion of the European Community single market by 1993, see From the Common Market to EC 92: Regional Economic Integration in the European Community and Transnational Corporations (United Nations publication, Sales No. E.93.II.A.2).

18/ Regional Economic Integration and Transnational Corporations in the 1990s: Europe 1992, North America, and Developing Countries (United Nations publication, Sales No. E.90.II.A.14).

19/ See E/C.10/1993/2. To the extent that investment outflows are positive, the outward stock increases.

20/ Ibid. The conversion of global foreign-direct-investment stock data from national currencies into dollars is bound to reflect valuation changes resulting from exchange-rate fluctuations. Nevertheless, even when stocks are reported in special drawing rights, their annual growth rate during the second half of the 1980s is almost two times higher than during the first half.

21/ John H. Dunning, Multinational Enterprises and the Global Economy (Wokingham, United Kingdom, Addison-Wesley, 1993).

22/ World Investment Report 1992 ..., p. 20.

23/ The Process of Transnationalization and Transnational Mergers (United Nations publication, Sales No. E.89.II.A.4).

24/ United States, Department of Commerce, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1989 Benchmark Survey (Washington, D.C., Government Printing Office, 1992).